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No. _____

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1991

THE FIRST NATIONAL BANK OF CHICAGO,
as Trustee of Institutional Real Estate Fund F,

Petitioner,

v.

THE COMPTROLLER OF THE CURRENCY
OF THE UNITED STATES,

Respondent.

Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Seventh Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the National Bank Act and regulations of the Comptroller of the Currency completely displace ERISA's fiduciary rules when a national bank acts as an ERISA trustee, as the court of appeals held without attempting to harmonize the Bank Act and ERISA as required by this Court's decisions in *Patterson v. Shumate*, *Guidry v. Sheet Metal Workers*, and *Morton v. Mancari*.

2. Whether the Comptroller's "interpretation" of his regulations was arbitrary and capricious, an abuse of discretion and not in accordance with law, and was actually an invalid amendment of the regulations without the notice and comment required by the Administrative Procedure Act, because the Comptroller disregarded the plain language of the regulations, changing the regulations and creating a direct conflict with ERISA.

PARTIES BELOW

The parties to the proceeding below were The First National Bank of Chicago, as Trustee of the Institutional Real Estate Fund F, the Comptroller of the Currency of the United States, and the Office of the Comptroller.

RULE 29.1 STATEMENT

The parent company of The First National Bank of Chicago is the First Chicago Corporation. Subsidiaries of The First National Bank of Chicago that are not wholly owned are Dearborn Park Corporation and Resort Holding Corporation.

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

PARTIES BELOW ii

RULE 29.1 STATEMENT ii

TABLE OF CONTENTS iii

TABLE OF AUTHORITIES v

OPINIONS BELOW 1

JURISDICTION 2

STATUTES AND REGULATIONS INVOLVED 2

STATEMENT OF THE CASE 3

REASONS FOR GRANTING THE PETITION 6

Summary 6

I. THE COURT OF APPEALS' DECISION CONTRADICTS *GUIDRY* AND *PATTERSON* AND AUTOMATICALLY NULLIFIES ERISA WHENEVER A NATIONAL BANK ACTS AS AN ERISA FIDUCIARY 8

A. The Court Of Appeals Offered No Reasons For Ignoring *Guidry* And Nullifying ERISA In Favor Of The Bank Act 8

B. Subordinating ERISA's Specific Provisions To The OCC's General Regulations Conflicts With The Congressional Intent That ERISA Provide Comprehensive And Flexible Rules For Employee Benefit Plans ... 13

1. ERISA Provides Comprehensive Regulation 14

TABLE OF CONTENTS – Continued

Page

2. ERISA Renounces Rigid Fiduciary Rules..... 15

C. Even If Federal Law Generally Supersedes ERISA Under § 514(d), Here The Bank Act And The OCC's Regulations Incorporate And Recognize The Continued Applicability Of ERISA As "Local Law" 18

II. THE OCC'S INTERPRETATION OF ITS REGULATIONS IS BOTH SUBSTANTIVELY AND PROCEDURALLY INVALID..... 21

A. The OCC's Interpretation Of § 9.18(b)(6), In Conflict With Its Plain Language, Is Arbitrary And Capricious, An Abuse Of Discretion, And Otherwise Not In Accordance With Law 21

B. The OCC's Reinterpretation Of § 9.18(b)(6) Effectively Amends The Regulation And, Without Notice And Comment, Violates The Administrative Procedure Act 23

CONCLUSION 24

APPENDIX A: Opinion and Judgment of the Court of Appeals.....A-1

APPENDIX B: Memorandum Opinion and Order of the District Court..... A-21

APPENDIX C: Comptroller's Letter Ruling of July 17, 1990.....A-35

APPENDIX D: Statutes and Regulations Involved... A-50

TABLE OF AUTHORITIES

Page

CASES

Bahramizadeh v. United States I.N.S., 717 F.2d 1170 (7th Cir. 1983) 22

Block v. North Dakota, 461 U.S. 273 (1983) 11

California Save Our Streams Council, Inc. v. Yeutter, 887 F.2d 908 (9th Cir. 1989) 11

Chertkof v. United States, 676 F.2d 984 (4th Cir. 1982) 22

Chrysler Corp. v. Brown, 441 U.S. 281 (1979) 23, 24

Donovan v. Bierwirth, 680 F.2d 263 (2d Cir. 1982), *cert. denied*, 459 U.S. 1069 (1983) 16

Donovan v. Mazzola, 716 F.2d 1226 (9th Cir. 1983), *cert. denied*, 464 U.S. 1040 (1984) 16

Fort Halifax Packing Co. v. Coyne, 482 U.S. 1 (1987) 14, 15

Guidry v. Sheet Metal Workers National Pension Fund, 493 U.S. 365 (1990) ..... *passim*

In re Request for Assistance, 848 F.2d 1151 (11th Cir. 1988), *cert. denied*, 488 U.S. 2705 (1989) 22

Ingersoll-Rand Co. v. McClendon, 111 S.Ct. 478 (1990) 14

Linoz v. Heckler, 800 F.2d 871 (9th Cir. 1986) 24

Morton v. Mancari, 417 U.S. 535 (1979) 7, 11, 20

N.L.R.B. v. Wyman-Gordon Co., 394 U.S. 759 (1969) 24

N.L.R.B. Union v. Federal Labor Relations Authority, 834 F.2d 191 (D.C. Cir. 1987) 20

Old Stone Bank v. Michaelson, 439 F. Supp. 252 (D.R.I. 1977) 19

TABLE OF AUTHORITIES – Continued

Page

Patterson v. Shumate, No. 91-913, 1992 WL 127069 (U.S. June 15, 1992) ..... *passim*

Pilot Life Insurance Co. v. Dedeaux, 481 U.S. 41 (1987) 14

Shaw v. Delta Air Lines, Inc., 463 U.S. 85 (1983) 11-14

Smoot v. United States, 892 F.2d 597 (7th Cir. 1989) 20

United States v. Yuginovich, 256 U.S. 450 (1921) 13

W.C. v. Bowen, 807 F.2d 1502 (9th Cir. 1987) 24

STATUTES

Administrative Procedure Act

5 U.S.C. § 553 ..... 8, 23

5 U.S.C. § 702 2

Bankruptcy Code

11 U.S.C. § 541(c)(2) 11

National Bank Act of 1864

12 U.S.C. § 1 3

12 U.S.C. § 92a(a) 18

28 U.S.C. § 1254 2

Employee Retirement Income Security Act of 1974

29 U.S.C. § 1001 3

29 U.S.C. § 1002(21)(A) (ERISA § 3(21)(A)) 9

29 U.S.C. § 1056(d)(1) (ERISA § 206(d)(1)) 11

29 U.S.C. § 1104(a)(1) (ERISA § 404(a)(1)) 9, 16

TABLE OF AUTHORITIES – Continued

Page

29 U.S.C. § 1144(a) (ERISA § 514(a)) 14, 19

29 U.S.C. § 1144(b) (ERISA § 514(b)) 19

29 U.S.C. § 1144(d) (ERISA § 514(d)) ..... *passim*

FEDERAL REGULATIONS

12 C.F.R. § 9.1(g) 19

12 C.F.R. § 9.11(a) 18

12 C.F.R. § 9.17(c)(6) (1962) 21

12 C.F.R. § 9.18(a) 18

12 C.F.R. § 9.18(b)(4) 5

12 C.F.R. § 9.18(b)(6) ..... *passim*

12 C.F.R. § 206.17(6) (1937) 21

2 Fed. Reg. 2976 (1937) 21

28 Fed. Reg. 1111 (1963) 23

28 Fed. Reg. 3309 (1963) 21, 23

47 Fed. Reg. 27,828 (1982) 19

MISCELLANEOUS

H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. (1974), *reprinted in* 1974 U.S. Code Cong. & Ad. News 5038 15

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THE FIRST NATIONAL BANK OF CHICAGO,
as Trustee of Institutional Real Estate Fund F,

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THE COMPTROLLER OF THE CURRENCY
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Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Seventh Circuit

PETITION FOR A WRIT OF CERTIORARI

The First National Bank of Chicago, as Trustee of Institutional Real Estate Fund F, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit entered in this case on February 14, 1992.

OPINIONS BELOW

The opinion of the court of appeals is reported at 956 F.2d 1360 and is attached hereto as Appendix A. The

opinion of the district court is unreported and is attached hereto as Appendix B.*

JURISDICTION

Invoking jurisdiction under 5 U.S.C. § 702, petitioner commenced this action in the United States District Court for the Northern District of Illinois. On August 6, 1991, the district court granted summary judgment partially in favor of petitioner and partially in favor of respondent.

On February 14, 1992, on cross-appeals from that judgment, the United States Court of Appeals for the Seventh Circuit modified the judgment and affirmed. No petition for rehearing was filed.

On May 12, 1992, Justice Stevens ordered that the time for filing this petition for a writ of certiorari be extended to and including June 18, 1992.

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED

The primary statutes and regulations involved are set forth in Appendix D attached hereto.

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* Citations herein to the attached appendices appear as (for example) "App. A" or "App. B at A-28."

STATEMENT OF THE CASE

Institutional Real Estate Fund F ("the fund" or "Fund F") is a "collective investment fund" which invests in commercial real estate throughout the United States. It was established in 1972 as an investment vehicle for tax-exempt employee benefit plans. All Fund F investors or "participants" are employee benefit plans. Consequently Fund F is subject to the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1001 *et seq.*, and regulations thereunder.*

The First National Bank of Chicago ("Trustee") is the Trustee of Fund F and as such is subject to ERISA and its regulations. As a national bank, the Trustee is also subject generally to regulation by the Comptroller of the Currency ("Comptroller" or "OCC") under the National Bank Act of 1864 ("the Bank Act"), 12 U.S.C. § 1 *et seq.* Pursuant to the Bank Act, the OCC has authorized national banks to administer "collective investment funds" as trustees. Unlike Fund F, however, many of these collective investment funds are not designed for ERISA plans, do not have ERISA plans as participants, and hence are not subject to ERISA.

During the relevant period Fund F has had 45 participants. Their investments in the fund range from approximately $50,000 to $70,000,000. In 1990 the fund held

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* Some Fund F participants are state and local government employee plans which are not subject to ERISA. It is undisputed, however, that Fund F itself is subject to ERISA's provisions and regulations.

approximately 60 real estate properties with an approximate aggregate appraised value of $490,000,000, plus approximately $59,000,000 in cash and cash equivalents.

This case concerns the Trustee's attempts to respond to the collapse in the U.S. commercial real estate market in the late 1980's. By late 1989 withdrawal requests from participants had exceeded the fund's available cash. Exercising its discretion as a fiduciary, the Trustee decided not to raise cash by hastily selling off (or mortgaging) properties in a depressed market. It temporarily suspended withdrawals and distributions and in early 1990 made a "restructuring" proposal under which the Trustee would distribute whole properties to participants either as part of the fund's restructuring or simply as a means to meet pending withdrawal requests. The Trustee, fulfilling its fiduciary duty under ERISA, determined that this was the only course of action that was prudent and fair to all fund participants. The alternatives, which the Trustee deemed to be imprudent and unfair, were to liquidate particular properties at forced-sale prices (or mortgage them, thereby changing the investment characteristics of the fund through leveraging, rendering the fund even more illiquid) in order to satisfy withdrawal requests in cash; or to distribute fractional pro rata interests in all of the fund's properties, which the Trustee and its advisers concluded would seriously impair the value of each property.

The Trustee's restructuring proposal was accepted by 37 of the fund's 45 participants (representing more than 80% of the fund's value) but was rejected by the Comptroller. In a letter ruling dated July 17, 1990 (App. C), the Comptroller asserted that OCC regulations permitted

only the distribution of cash or fractional pro rata interests in all of the fund's properties and required all withdrawal requests to be satisfied within one year, even though the Trustee had concluded that such distributions were improper under ERISA. This ruling was based on the Comptroller's interpretation of two OCC regulations: 12 C.F.R. § 9.18(b)(6), which states that distributions to satisfy requests for withdrawal from a collective investment fund "may be made in cash or ratably in kind, or partly in cash and partly in kind"; and 12 C.F.R. § 9.18(b)(4), which states that satisfaction of withdrawal requests may be delayed no more than one year after notice of the request is given. These OCC regulations apply to all collective investment funds generally, whether they constitute ERISA trusts or not.

The Trustee sought review of the Comptroller's ruling in the United States District Court for the Northern District of Illinois. On August 6, 1991, the district court entered summary judgment, holding that the Trustee could use whole properties to meet matured withdrawal requests under § 9.18(b)(6) (concerning in-kind distributions) but that the restructuring proposal itself violated § 9.18(b)(4) (requiring distributions to be made within one year). (App. B.)

Both the Trustee and the Comptroller appealed to the United States Court of Appeals for the Seventh Circuit. In the court of appeals, the Comptroller stated that the only dispute between the parties concerned the use of whole properties either as part of the restructuring proposal or to satisfy individual withdrawal requests. On February 14, 1992, the court of appeals held that both regulations supported the Comptroller's rejection of the restructuring

proposal and that the Comptroller could properly interpret § 9.18(b)(6) to prohibit any distribution of whole properties. It modified the district court's judgment accordingly and affirmed. In a brief remark at the end of its opinion, the court of appeals ruled that the Comptroller's regulations automatically superseded ERISA. (App. A at A-19; 956 F.2d at 1368: "There can be no violation of ERISA itself because that statute is explicit that it shall not be construed to invalidate or impair any federal regulation.")

REASONS FOR GRANTING THE PETITION

Summary

This case raises an important question about the necessary reconciliation of two federal statutes, ERISA and the Bank Act. The court of appeals refused to attempt that reconciliation. It simply concluded without analysis that ERISA was irrelevant because ERISA does not "invalidate or impair any [other] federal regulation," including OCC regulations under the Bank Act. (App. A at A-19; 956 F.2d at 1368.) That ruling ignores and contradicts this Court's decision in *Guidry v. Sheet Metal Workers National Pension Fund*, 493 U.S. 365 (1990), which holds that ERISA's specific provisions for the protection of employee benefit plans may take precedence over more general provisions in other federal statutes. Recently, the analysis in *Guidry* was unanimously reaffirmed by this Court in *Patterson v. Shumate*, No. 91-913, 1992 WL 127069 (U.S. June 15, 1992). (Pp. 8-13 *infra*.)

If the court of appeals' decision is allowed to stand, employee benefit plans that happen to invest in collective investment funds administered by national banks will automatically lose their protections under ERISA in the face of any conflicting OCC regulations -- regulations which are not geared to ERISA plans, and which the Comptroller now says must be "rigidly" applied to require forms of distribution even if the trustee deems them to be improper under ERISA. This would frustrate the basic Congressional intent, repeatedly confirmed by this Court, to establish under ERISA a comprehensive and unified regime with flexible fiduciary rules for managing employee benefit plans, wherever their assets are invested. (Pp. 13-17 *infra*.)

The court of appeals' decision would also extend the Comptroller's regulations beyond the scope permitted by the Bank Act itself. The Bank Act does not allow the Comptroller's regulations to contravene "local law," which, as the Comptroller has expressly conceded, includes ERISA. Thus, to the extent that the Comptroller's regulation (as now interpreted) violates "local law," it also violates the Bank Act itself and the regulation (so interpreted) is void. That conclusion is squarely required by this Court's recent decision in *Patterson v. Shumate, supra*, which holds that ERISA's anti-alienation provision prevails because it is incorporated by the Bankruptcy Code's reference to "applicable nonbankruptcy law" — a result clearly anticipated by *Guidry* and other cases. And by allowing the OCC's regulations to override ERISA, the court of appeals' decision failed to implement this Court's decision in *Morton v. Mancari*, 417 U.S. 535, 550-51 (1979), which holds that where two federal statutes

apparently conflict, the courts must attempt to harmonize them before either is nullified or impaired. (Pp. 18-21 *infra.*)

Finally, the Comptroller's interpretation of 12 C.F.R. § 9.18(b)(6) – that mixed cash-and-property distributions must involve fractional prorated interests in all of the fund's properties and may not include whole properties – is arbitrary and capricious, an abuse of discretion, and not in accordance with law. Although the regulation previously required distributions "partly in cash and partly *ratably* in kind" (emphasis added), the word "ratably" was deleted in the current version of the regulation. The Comptroller conceded that this deletion was deliberate. Under these circumstances the Comptroller's interpretation of § 9.18(b)(6) perversely contradicts the plain language of the regulation, which, if applied simply as written, would avoid the conflict with ERISA. (Pp. 21-22 *infra.*) Moreover, the Comptroller's "interpretation" effectively amends the regulation by re-inserting the previously deleted language. Such an amendment, without notice and an opportunity to comment, is invalid under the Administrative Procedure Act, 5 U.S.C. § 553. (Pp. 23-24 *infra.*)

I.

THE COURT OF APPEALS' DECISION CONTRADICTS *GUIDRY* AND *PATTERSON* AND AUTOMATICALLY NULLIFIES ERISA WHENEVER A NATIONAL BANK ACTS AS AN ERISA FIDUCIARY

A. The Court Of Appeals Offered No Reasons For Ignoring *Guidry* And Nullifying ERISA In Favor Of The Bank Act

Fund F is an investment fund that pools the assets of employee benefit plans. Fund F is an ERISA trust and the

Trustee, as manager of the fund, is a fiduciary under ERISA.* The Trustee therefore is bound by ERISA's fiduciary responsibility rules in managing the fund's assets, including the requirement that the Trustee manage those assets fairly and prudently for the benefit of all participants.**

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* ERISA § 3(21)(A) (29 U.S.C. § 1002(21)(A)) provides:

> [A] person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.

** ERISA § 404(a)(1) (29 U.S.C. § 1104(a)(1)) provides:

> [A] fiduciary shall discharge his duties with respect to a plan *solely in the interest* of the participants and beneficiaries and –
>
> (A) for *the exclusive purpose* of:
>
> (i) providing benefits to participants and their beneficiaries; and
>
> (ii) defraying reasonable expenses of administering the plan;
>
> (B) *with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use* in the conduct of an enterprise of a like character and with like aims;

(Continued on following page)

Nevertheless, in a single sentence at the end of its opinion the court of appeals dismissed all of ERISA's provisions as irrelevant. The court held that the Trustee was bound to obey OCC regulations under the Bank Act without regard to ERISA. In the court's view, compliance with the Comptroller's ruling could never constitute an ERISA violation "because [ERISA] is explicit that it shall not be construed to invalidate or impair any federal regulation." (App. A at A-19; 956 F.2d at 1368.) The court cited ERISA § 514(d) (29 U.S.C. § 1144(d)) for this sweeping proposition but offered no other authority or analysis.

That holding ignores *Guidry v. Sheet Metal Workers National Pension Fund*, 493 U.S. 365 (1990), which rejects the notion that ERISA § 514(d) automatically subordinates ERISA to all other federal law. This Court held in *Guidry* that general provisions of the Labor-Management Reporting and Disclosure Act ("LMRDA") authorizing "appropriate relief" for embezzlement of pension funds did not supersede ERISA's more specific anti-alienation provision, which precludes imposing a constructive trust on the embezzler's own pension benefits as a form of "appropriate relief." The Court stated:

(Continued from previous page)

> (C) *by diversifying* the investments of the plan so as to minimize the risk of large losses, *unless under the circumstances it is clearly prudent not to do so;* and
>
> (D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this title and title IV.

(Emphasis added.)

> Were we to accept respondents' position, ERISA's anti-alienation provision would be inapplicable whenever a judgment creditor relied on the remedial provisions of a federal statute. Such an approach would eviscerate the protections of [ERISA's anti-alienation provision], *and we decline to adopt so broad a reading of § 514(d).*

493 U.S. at 375 (emphasis added). Instead, this Court held, § 514(d) must be read in conjunction with the rule that specific statutory provisions prevail over more general ones, unless there is clear direction to the contrary. *Id.* (citing *Morton v. Mancari*, 417 U.S. 535, 550-51 (1974)). There was no such clear direction in *Guidry*, and there is none here.*

This Court recently and unanimously reaffirmed *Guidry* in *Patterson v. Shumate*, No. 91-913, 1992 WL 127069 (U.S. June 15, 1992), which holds that ERISA protects the pension-plan benefits of a bankrupt debtor from inclusion in the debtor's bankruptcy estate. The Court ruled that the Bankruptcy Code's reference to "applicable nonbankruptcy law" (11 U.S.C. § 541(c)(2)) incorporates and thus defers to the anti-alienation provision in ERISA § 206(d)(1) (29 U.S.C. § 1056(d)(1)), thereby harmonizing the Bankruptcy Code with ERISA.

Earlier, in *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85 (1983), the Court had already indicated that ERISA

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* *Cf. Block v. North Dakota*, 461 U.S. 273, 285 (1983) (applying "the rule that a precisely drawn, detailed statute pre-empts more general remedies"); *California Save Our Streams Council, Inc. v. Yeutter*, 887 F.2d 908, 911 (9th Cir. 1989).

§ 514(d) was designed to enhance, rather than limit or erase, ERISA's protections. There the Court found that § 514(d) preserved the applicability of the anti-discrimination provisions of Title VII of the federal Civil Rights Act of 1964. But this did not mean that an "expansive" view of § 514(d) was warranted:

> ERISA's structure and legislative history, while not particularly illuminating with respect to § 514(d), caution against applying it too expansively. . . . The references to employment discrimination in the legislative history of ERISA provide no basis for an expansive construction of § 514(d). During floor debates, Senator Mondale questioned whether the Senate bill should be amended to require nondiscrimination in ERISA plans. Senator Williams replied that no such amendment was necessary or desirable. He noted that Title VII already prohibited discrimination in benefit plans. . . .

463 U.S. at 104.

Under § 514(d) ERISA's drafters intended to preserve the applicability of provisions such as title VII so that such protections could be omitted from the text of ERISA itself, thereby avoiding unnecessary reiterations. However, when it came to the fiduciary rules that would govern ERISA trustees, Congress specifically provided those rules in ERISA and did not rely on other federal statutes (much less OCC regulations) to supply them. Properly interpreted, therefore, § 514(d) allows other federal law to supplement ERISA whenever such other law is consistent with or enhances ERISA's special protections. It does not obliterate ERISA in favor of any inconsistent or conflicting federal law with respect to

managing ERISA assets, especially where the other law is more general than ERISA's specific provisions.

Guidry and *Shaw* should have been applied here (as now confirmed by *Patterson*). The Comptroller's regulations under the Bank Act apply generally to all collective investment funds, whatever their assets and whoever their participants may be. In contrast, ERISA was designed to protect the assets of a specific category of funds — employee benefit plans. Congress intended ERISA to supersede inconsistent state law and, as *Guidry* holds, more general federal laws. Under *Guidry*, petitioner submits, ERISA continues to govern the management and distribution of an ERISA trust's assets. The court of appeals should have considered this issue rather than simply dismissing it.*

B. Subordinating ERISA's Specific Provisions To The OCC's General Regulations Conflicts With The Congressional Intent That ERISA Provide Comprehensive And Flexible Rules For Employee Benefit Plans

Acknowledgment of ERISA's applicability here was all the more important in view of ERISA's intent to

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* ERISA also is a more recent enactment than either the Bank Act or the OCC regulations in issue. ERISA was enacted in 1974. The current version of § 9.18(b)(6) was promulgated in 1963, its precursor was promulgated in 1937, and the relevant provisions of the Bank Act were enacted in 1913 (38 Stat. 261) and most recently re-enacted in 1962 (80 Stat. 161). If Congress intended any federal provision to override another, the most recent provision normally would take precedence. *See, e.g., United States v. Yuginovich*, 256 U.S. 450, 463 (1921).

establish *comprehensive* and *flexible* fiduciary standards which supersede other law. These aims have been confirmed and implemented by this Court's ERISA jurisprudence.

1. ERISA Provides Comprehensive Regulation

ERISA is a comprehensive statute for the protection of employee benefit plans. The Congressional intent in enacting ERISA was to codify an integrated regime governing all aspects of plan administration. *See, e.g., Ingersoll-Rand Co. v. McClendon,* 111 S.Ct. 478, 482 (1990); *Pilot Life Insurance Co. v. Dedeaux,* 481 U.S. 41, 52 (1987); *Shaw, supra,* 463 U.S. at 90-91.

This Court has repeatedly affirmed ERISA's role as the comprehensive source of regulation for the management of employee benefit plans. For example, in *Fort Halifax Packing Co. v. Coyne,* 482 U.S. 1 (1987), discussing state-law preemption under ERISA § 514(a), the Court stated:

> [ERISA recognizes] that employers establishing and maintaining employee benefit plans are faced with the task of coordinating complex administrative activities. *A patchwork scheme of regulation would introduce considerable inefficiencies in benefit program operation,* which might lead those employers with existing plans to reduce benefits, and those without such plans to refrain from adopting them. Pre-emption ensures that the administrative practices of a benefit plan will be governed by only a single set of regulations. . . . Congress intended pre-emption to afford employers *the advantages of a uniform set of*

administrative procedures governed by a single set of regulations.

482 U.S. at 11 (emphasis added).

This position was reaffirmed just a few days ago in *Patterson v. Shumate, supra,* when the Court unanimously held that ERISA bars the inclusion of pension benefits in a bankruptcy estate. Citing *Fort Halifax,* the Court declared that "our holding furthers another important policy underlying ERISA: uniform national treatment of pension benefits." 1992 WL 127069, at p. 6. Under *Patterson,* this policy extends to both state and other *federal* law (such as the Bankruptcy Code).

The identical considerations apply here. Unless there is clear Congressional intent to the contrary, ERISA supplies the "single set of regulations" for the federal governance of ERISA plan administration, including the management and distribution of plan assets.

2. ERISA Renounces Rigid Fiduciary Rules

In drafting ERISA, Congress carefully avoided imposing inflexible fiduciary rules. Congress wanted fiduciaries to have the flexibility to act in the best interests of plan participants and beneficiaries, "bearing in mind the special nature and purpose of employee benefit plans." H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. (1974), *reprinted in* 1974 U.S. Code Cong. & Ad. News 5038, 5083. Thus ERISA's prudence standards require a fiduciary to consider each specific transaction at the time

it occurs and to employ "appropriate methods to . . . structure the investment."*

Any requirement that a plan fiduciary follow a general course of action in managing or distributing assets, without evaluating the specific circumstances prevailing at the time, is improper under ERISA. Yet the flexibility and case-by-case determinations required of fiduciaries by ERISA are prohibited by the OCC's regulations as now interpreted by the Comptroller — regulations which the Comptroller insists must be "rigidly" applied (App. B at A-28, n.1) and which dictate both the timing and the content of plan distributions. The Comptroller has determined that distributions must be made within one year and must be made with cash or, if property is used, with fractionalized interests in each and every property in the fund's portfolio. These dictates are imposed without regard to whether, under the prevailing circumstances, such distributions serve the best interests of all of the plan's beneficiaries and thus meet the prudence and fairness standards of ERISA. Consequently the OCC would forbid the Trustee from acting on its judgment as a fiduciary that distributing whole properties is more prudent and fair under the circumstances than conducting "fire

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* *Donovan v. Mazzola*, 716 F.2d 1226, 1232 (9th Cir. 1983), *cert. denied*, 464 U.S. 1040 (1984); *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982), *cert. denied*, 459 U.S. 1069 (1983).

ERISA does not even impose a general requirement of diversification; a trustee is required to diversify investments only to the extent that, "under the circumstances, it is clearly prudent" to do so. ERISA § 404(a)(1)(C) (29 U.S.C. § 1104(a)(1)(C)).

sales" to raise cash, or fractionalizing (and thus depressing the market value of) each property.

The OCC's position that the Trustee must ignore its responsibilities under ERISA leads to highly anomalous results. Nothing supports the notion that Congress intended to set up to two radically different and mutually exclusive regulatory regimes for ERISA plans: (1) rigid, non-specific OCC regulation for ERISA plan assets that happen to be invested in a collective investment fund administered by a national bank; and (2) flexible, case-by-case regulation under ERISA for all other plan assets. Yet that is the effect of the decision below.

This result plainly conflicts with the Court's ERISA jurisprudence, including most recently *Patterson v. Shumate, supra*. There, in holding that ERISA protects pension benefits even when the beneficiary enters bankruptcy proceedings, the Court emphasized that "our decision today ensures that the treatment of pension benefits will not vary based on the beneficiary's bankruptcy status." 1992 WL 127069, at p. 5. Similarly, the treatment of pension plan assets should not vary based on whether those assets happen to be invested with a national bank as opposed to some other trustee.

The decision below leads to such haphazard variation, without moorings in either statutory language or Congressional intent. Given ERISA's special purpose and comprehensive scope, Congress surely did not intend that ERISA would be cancelled automatically by OCC regulations that apply generally to all collective investment funds. Section 514(d) of ERISA cannot properly be read so expansively.

C. Even If Federal Law Generally Supersedes ERISA Under § 514(d), Here The Bank Act And The OCC's Regulations Incorporate And Recognize The Continued Applicability Of ERISA As "Local Law"

Even if in other contexts § 514(d) could be interpreted expansively to subordinate ERISA to other federal laws, no such reading is appropriate here because the "other federal law" in question — the Bank Act and OCC regulations thereunder — incorporate and defer to ERISA. At a minimum, therefore, the court of appeals should have attempted to harmonize ERISA and the Bank Act rather than nullifying ERISA.

Under the Bank Act the Comptroller may authorize national banks to act as trustees or other fiduciaries to the same extent that state banks are permitted to do so under state law, as long as there is no "contravention of State or local law." 12 U.S.C. § 92a(a). In providing this authorization, the Comptroller's regulations similarly state:

> *Where not in contravention of local law,* funds held by a national bank as fiduciary may be invested collectively . . . [i]n a fund consisting solely of assets of retirement, pension, profit sharing, stock bonus or other trusts which are exempt from Federal income taxation under the Internal Revenue Code.

12 C.F.R. § 9.18(a) (emphasis added).*

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* *See also* 12 C.F.R. § 9.11(a) ("Funds held by a national bank in a fiduciary capacity shall be invested in accordance with the instrument establishing the fiduciary relationship *and local law*") (emphasis added).

For purposes of the Bank Act, "local law" means "the law of the state or other jurisdiction governing the fiduciary relationship." 12 C.F.R. § 9.1(g). In its July 17, 1990 letter ruling, the OCC specifically acknowledged that this definition of local law includes ERISA. (App. C at A-45.)*

To the extent that the OCC has now interpreted and applied its regulation in contravention of local law — by requiring fractional distributions of properties even if, under the prevailing circumstances, such distributions would be imprudent and thus improper under ERISA —

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* Under OCC regulations, "local law" is defined as either state law or the law of any other applicable jurisdiction. 12 C.F.R. § 9.1(g). Local law cannot include state law with respect to Fund F, however, because state law is preempted by ERISA. ERISA § 514(a) (29 U.S.C. § 1144(a)). Although § 514(a) exempts from preemption state banking law, the exemption does not preserve any state law which purports to regulate the fund as a "bank." ERISA § 514(b)(2)(B) (29 U.S.C. § 1144(b)(2)(B)). *See also Old Stone Bank v. Michaelson,* 439 F. Supp. 252 (D.R.I. 1977) (exception to ERISA's preemption provision for state banking law does not apply where state law seeks to regulate retirement plans).

Once state law is eliminated, local law is defined simply as the law of any applicable jurisdiction. As it relates to employee benefit plans, this definition must include ERISA. Otherwise the phrase "any other applicable jurisdiction" in the definition of local law would be rendered meaningless.

The Comptroller also recognized ERISA's applicability in promulgating the regulation requiring a one-year notice period for withdrawals, stating that "employee benefit plans are already governed by . . . ERISA." 47 Fed. Reg. 27,828, 27,831 (1982).

the regulation conflicts with the OCC's own enabling statute, the Bank Act, and the regulation is void.*

Alternatively, at the very least an attempt must be made to harmonize the regulation with ERISA as "local law." In *Patterson v. Shumate, supra,* this Court unanimously held that the Bankruptcy Code's reference to "applicable nonbankruptcy law" — a provision similar to the Bank Act's reference to "local law" — incorporated not only state law relating to spendthrift trusts but also federal law in the form of ERISA's anti-alienation provisions. ERISA therefore continued to have full effect in protecting pension benefits from proceedings under the Bankruptcy Code. This result also comports with long-standing principles of statutory construction. As this Court held in *Morton v. Mancari,* 417 U.S. 535, 551 (1974), courts (and regulators) have an obligation to harmonize federal statutes whenever possible. Both the OCC and the court of appeals ignored this requirement.

Harmonization would have been easily accomplished here. It simply required implementing the Bank Act's deference to "local law" and the OCC's own express recognition that ERISA constitutes "local law." Then, if the OCC's regulations do not contravene ERISA, the regulations would apply as written to collective investment funds; if a contravention occurs, the regulations would be

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* *See, e.g., N.L.R.B. Union v. Federal Labor Relations Authority,* 834 F.2d 191, 198-99 (D.C. Cir. 1987) (if an agency's regulations contravene Congressional intent, "they must be struck down, notwithstanding [the agency's] contrary opinion"); *Smoot v. United States,* 892 F.2d 597, 602 (7th Cir. 1989).

interpreted to permit the case-by-case analysis of prudence and fairness required by ERISA. Here the Comptroller rejected this approach and the court of appeals concurred, thereby displacing ERISA completely. This radical impairment of ERISA was improper.

II.

THE OCC'S INTERPRETATION OF ITS REGULATIONS IS BOTH SUBSTANTIVELY AND PROCEDURALLY INVALID

A. The OCC's Interpretation Of § 9.18(b)(6), In Conflict With Its Plain Language, Is Arbitrary And Capricious, An Abuse Of Discretion, And Otherwise Not In Accordance With Law

12 C.F.R. § 9.18(b)(6) states that distributions from a collective investment fund are to be distributed "in cash, *ratably* in kind, or partly in cash and partly in kind. . . . " (Emphasis added.) On its face the regulation does not require ratable distributions when the distributions are made "partly in cash and partly in kind." The Comptroller's ruling in this case turns that language on its head.

The precursor of § 9.18(b)(6), first promulgated in 1937, *did* require ratable distributions in any form. The original regulation stated that "distributions may be made in cash or ratably in kind, or partly in cash and partly *ratably* in kind . . . . " 12 C.F.R. § 206.17(6), 2 Fed. Reg. 2976, 2978 (1937) (emphasis added); 12 C.F.R. § 9.17(c)(6) (1962). In 1963 the Comptroller deleted the second "ratably" which referred to mixed cash-and-property distributions. 28 Fed. Reg. 3309, 3312 (1963). The

Comptroller conceded below that this deletion was deliberate. (App. A at A-11; 956 F.2d at 1365.) Nevertheless the Comptroller now wishes to "interpret" the regulation as if he never made that deliberate deletion. This interpretation contradicts the plain language of the regulation and defies basic rules of statutory construction. It is plainly improper.

The Comptroller's position violates the canon of construction that when words are deleted the meaning of the statute or regulation changes. *In re Request for Assistance*, 848 F.2d 1151, 1154-55 (11th Cir. 1988), *cert. denied*, 488 U.S. 2705 (1989) (a deletion of language "generally indicates an intent to change the meaning of the statute"); *Chertkof v. United States*, 676 F.2d 984, 987 (4th Cir. 1982) (when words of plain meaning are excised, the deletion "almost compels the opposite result").

A regulator may not discard the plain wording of a regulation by purported "interpretation." *See, e.g., Bahramizadeh v. United States I.N.S.*, 717 F.2d 1170, 1173 (7th Cir. 1983):

> An agency may not interpret its regulations in a manner so as to nullify the effective intent or wording of a regulation. Regulations promulgated pursuant to statutory authority have the force and effect of law, thereby making an agency bound by its own regulations.

A rule is worse than meaningless if regulators do not follow what it clearly says. The Comptroller's refusal to follow the language of his own regulation was arbitrary and capricious, an abuse of discretion, and not in accordance with law.

B. The OCC's Reinterpretation Of § 9.18(b)(6) Effectively Amends The Regulation And, Without Notice And Comment, Violates The Administrative Procedure Act

The Comptroller's ruling in effect changes the phrase "partly in cash and partly in kind" to "partly in cash and partly *ratably* in kind." As discussed above, the word "ratably" used to appear in that phrase but was purposely deleted in 1963. Re-insertion of that word now is a substantive amendment of § 9.18(b)(6) which requires public notice and comment under the Administrative Procedure Act ("APA"), 5 U.S.C. § 553. The OCC's failure to comply with the APA renders this amendment invalid.*

The OCC's interpretation substantively changes the regulation in a way that prohibits any mixed distributions of cash and whole properties. A change of this significance, which now bars an entire category of distributions and raises a direct conflict with ERISA, constitutes an amendment which (if authorized at all) could be made only by following the APA's requirements of public notice and comment. In fact, the OCC followed the APA's procedures when it deliberately deleted the word "ratably" in 1963. *See* 28 Fed. Reg. 1111, 1114 (1963); 28 Fed. Reg. 3309, 3312 (1963). The OCC must follow those procedures again to re-insert it.

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* There can be no doubt that § 9.18(b)(6) is a "substantive" rather than an "interpretive" rule, and as such can only be amended by adhering to the APA. "Substantive" rules are "legislative-type" rules that affect "individual rights and obligations" and are viewed as "binding" or having the "force of law." *See Chrysler Corp. v. Brown*, 441 U.S. 281, 302 (1979).

Adherence to APA requirements is not a mere formality. "[A]gency discretion is limited not only by substantive, statutory grants of authority, but also by the procedural requirements which 'assure fairness and mature consideration of rules of general application.' . . . The pertinent procedural limitations . . . are those found in the APA." *Chrysler Corp. v. Brown*, 441 U.S. 281, 303 (1979) (quoting *N.L.R.B. v. Wyman-Gordon Co.*, 394 U.S. 759, 764 (1969)). *See also W.C. v. Bowen*, 807 F.2d 1502, 1505 (9th Cir. 1987); *Linoz v. Heckler*, 800 F.2d 871, 877-78 (9th Cir. 1986).

The Comptroller cannot ignore these essential requirements.

CONCLUSION

The petition for a writ of certiorari should be granted and, if the Court deems it appropriate, the case should be remanded to the court of appeals for reconsideration in light of *Patterson v. Shumate*.

Respectfully submitted,

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June 18, 1992

APPENDIX A

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Nos. 91-3244, 91-3245
FIRST NATIONAL BANK OF CHICAGO, as Trustee
Of Institutional Real Estate Fund F,

Petitioner-Appellee-Cross-Appellant,

v.

COMPTROLLER OF THE CURRENCY OF THE UNITED STATES and
OFFICE OF THE COMPTROLLER OF THE CURRENCY,

Respondents-Appellants-Cross-Appellees.

Appeals from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 90 C 5963 – James B. Zagel, *Judge.*

ARGUED JANUARY 7, 1992 – DECIDED FEBRUARY 14, 1992

Before POSNER and EASTERBROOK, *Circuit Judges,* and ESCHBACH, *Senior Circuit Judge.*

POSNER, *Circuit Judge.* First National Bank of Chicago, as trustee of a real estate investment fund, brought this suit in federal district court against the Comptroller of the Currency to challenge his refusal to allow the bank to distribute individual properties owned by the fund to

withdrawing investors in lieu of either cashing them out or giving them proportional interests in the fund's entire portfolio of properties. Do not confuse this fund with a "Real Estate Investment Trust" (REIT), also a method of pooling real estate investments but one with special conditions not claimed to be satisfied here and an emphasis on tax avoidance that is irrelevant here because the participants in the fund are tax-exempt employee benefit plans. William A. Kelley, Jr., "How to Qualify a Real Estate Investment Trust (Part 1)," 6 *Practical Tax Lawyer* 31 (1991); Gregory W. Goff, "REIT Revival – An Overview of Real Estate Investment Trusts as an Investment Vehicle," 39 *Major Tax Planning*, ch. 19 (U.S.C. Law Center Tax Institute 1987). This is a bank-managed "collective investment fund," also known as a "common trust fund," which has been helpfully defined as "a group of investments managed by a bank in accordance with a written plan on behalf of several individual fiduciary accounts whose assets are lawfully contributed to the fund." William P. Wade, "Bank-Sponsored Collective Investment Funds: An Analysis of Applicable Federal Banking and Securities Laws," 35 *Business Lawyer* 361 (1980). See also *Investment Company Institute v. Camp*, 401 U.S. 617, 621-22 (1971); *Investment Company Institute v. Conover*, 790 F.2d 925, 928 (D.C. Cir. 1986). Our fund happens to invest in real estate rather than in securities but that is an idiosyncrasy of this fund rather than a part of the definition of a collective investment fund. National banks are empowered to manage collective investment funds and engage in other fiduciary activities by virtue of 12 U.S.C. § 92a(a).

The Comptroller based his refusal to permit the bank to compensate withdrawing investors in the proposed

manner on two regulations of his office governing the fiduciary powers of national banks. One provides that distributions to a withdrawing investor in a collective investment fund "may be made in cash or ratably in kind, or partly in cash and partly in kind." 12 C.F.R. § 9.18(b)(6). The Comptroller interprets this to bar the form of distribution proposed by the fund, under which a withdrawing participant could be made to accept an individual parcel (or parcels) of real estate in exchange for his shares in the fund rather than receiving a proportional interest in all the fund's properties. The other regulation provides that a fund that invests in real estate or other assets that are not readily marketable may require one year's prior notice of withdrawals from it – but no more. 12 C.F.R. § 9.18(b)(4).

Institutional Real Estate Fund F was established in 1972 and has 45 participants – all substantial, sophisticated employee benefit plans, whose investments in the fund range from $50,000 to $100 million. In 1990 the fund had $59 million in cash and cash equivalents plus some sixty commercial real estate properties having an aggregate appraised value of $490 million. Yet the fund was worth less than it had been. The commercial real estate market had faltered as the decade of the 1980s came to a close. The value of the fund's real estate holdings had declined by 10 percent, and withdrawal requests by investors in the fund had increased to the point where, by December 1989, the requests exceeded the fund's cash. The bank suspended further withdrawals and distributions. It could have sold some of the fund's properties to raise additional cash to fund withdrawals, but it didn't want to do this because of what it considered to be the

depressed state of the market for commercial real estate. In March 1990, with fifteen withdrawal requests, aggregating $135 million, pending, the bank proposed to the participants a restructuring of the fund whereby any investor that wanted to make an immediate withdrawal would receive "in-kind distributions of the whole ownership in certain real properties." Of the 45 participants, 37, owning in the aggregate 80 percent of the shares in the fund, agreed to the proposal.

The bank asked the Comptroller to rule that the proposal did not violate either of the regulations we have quoted, or in the alternative to grant a waiver from the regulations. The Comptroller wrote the bank that in his view the proposal violated both regulations and that he would not waive either of them. This lawsuit ensued. The district judge decided it on the pleadings – and rightly so, for although nominally an injunctive proceeding, in reality this is a proceeding to review agency action, and such proceedings are (with immaterial exceptions) decided on the record compiled before the agency. *Cronin v. United States Department of Agriculture*, 919 F.2d 439, 443-44 (7th Cir. 1990). The judge held that the regulation governing the form of distributions does not bar the proposed restructuring of the fund, but that the one-year limitation on notice of withdrawals does. Both parties have appealed.

There is jurisdictional underbrush to be cleared away before we can address the merits. First is the question of our appellate jurisdiction. The district court did not enter a separate judgment order, as required by Rule 58 of the Federal Rules of Civil Procedure. For when he ruled, a third count in the bank's complaint was unresolved, so

the judgment was not final and a Rule 58 order would have been premature. Later the parties agreed to drop the third count and an order dismissing it was duly entered on the docket sheet. But the clerk who entered it evidently did not realize that the order dismissing the remaining count made the earlier judgment final.

Although the parties should have realized this and asked the judge to enter a Rule 58 order, the absence of the order is not fatal to our jurisdiction. The applicable statute requires a final judgment, 28 U.S.C. § 1291 ("final decision" is the statutory term, but the cases usually speak of the "final judgment" rule), and the requirement is jurisdictional, and therefore not waivable. But the statute does not say that the final judgment must be in the form prescribed by Rule 58. Compliance with the rule makes it easier to determine whether there is a final judgment, but if we know from other sources that there is one, we have jurisdiction. *Bankers Trust Co. v. Mallis,* 435 U.S. 381 (1978) (per curiam); *F. & H.R. Farman-Farmaian Consulting Engineers Firm v. Harza Engineering Co.,* 882 F.2d 281, 283 (7th Cir. 1989); *Soo Line R.R. v. Escanaba & Lake Superior R.R.,* 840 F.2d 546, 549 (7th Cir. 1988).

Which is not to say that Rule 58 is one of those useless technicalities that bedevil and confuse the law. Compliance with it in this case might have avoided considerable confusion – might have told us for example who actually won in the district court (and therefore should be the appellant) and who lost (and therefore should be the appellee). Cf. *American Interinsurance Exchange v. Occidental Fire & Casualty Co.,* 835 F.2d 157 (7th Cir. 1987). Remarkably, this is quite unclear. One interpretation of the judgment is that the losing party in

the district court was the bank, because the court refused to vacate the Comptroller's refusal to permit the proposed restructuring to go forward. On this interpretation, only the bank should have appealed. The Comptroller should have defended the judgment as appellee, *Byron v. Clay*, 867 F.2d 1049, 1050-51 (7th Cir. 1989), albeit on a different ground from the district court's. Different because the Comptroller believes that his interpretation of the form-of-distribution regulation is correct and bars the restructuring, but that the one-year notice limitation, on the basis of which the district court upheld his refusal to permit the restructuring to proceed, has no *independent* significance. The reason is that if the form of distribution proposed by the bank is valid, the bank is agreeable to making the distributions authorized by it within one year of a request for withdrawal.

It could well be argued that given the Comptroller's position on the significance of the one-year regulation, his victory in the district court was Pyrrhic and might better be interpreted as a loss. For by rejecting his interpretation of the regulation governing the form of distribution, the district court made the one-year regulation in effect moot as applied to this case. The regulation bites only if the bank is required to cash out the withdrawing participants, for then it would have to sell off properties in a hurry, and it doesn't want to do this. If a withdrawing participant can be made to accept a whole-property distribution in kind, the bank is happy to make that distribution within one year of a request for it.

A party is allowed to appeal from a judgment nominally or for that matter substantially in his favor, provided only that it is adverse to him in some respect.

LaBuhn v. Bulkmatic Transport Co., 865 F.2d 119, 121-22 (7th Cir. 1988); *Disher v. Information Resources, Inc.*, 873 F.2d 136, 138-39 (7th Cir. 1989). The judgment of the district court was adverse to the Comptroller in a most important respect, for it upheld his action on a ground that would require him to rescind that action upon request by the bank. If he had not appealed, the bank would have resubmitted the request for restructuring, the Comptroller (not persuaded by the district judge's opinion) would have turned it down on the ground that the form-of-distribution regulation barred it, the bank would have sued once more in the district court, and the court would have reentered its order. There would be an endless merry-go-round. This is a practical reason for allowing the Comptroller to appeal.

Although it does not matter in this case whether only the bank, or only the Comptroller, or both, could appeal, it could matter in another case. Litigants in cross-appeal situations should be mindful that unless they are careful they may forfeit their right to all appellate review by standing on what they suppose to be their right to file a cross-appeal. If a timely notice of appeal is filed by one party, any other party may file its own notice of appeal within 14 days after that. Fed. R. App. Pro. 4(a)(3); *Seafarers Int'l Union v. NLRB*, 895 F.2d 385, 386 (7th Cir. 1990). But this is provided the first party had a right to appeal. If he did not, the second party must file within the normal time limit. *Hameetman v. City of Chicago*, 776 F.2d 636, 640 (7th Cir. 1985). If that is 60 days (as it was here, for there is a federal-government party, Fed. R. App. P. 4(a)(1)), and the first (the invalid) notice of appeal was filed on the fifty-ninth day and the second two days later,

there would be no appellate jurisdiction. That is not a problem here, however, because both parties filed their notices of appeal within the time for filing a direct appeal as distinct from a cross-appeal.

So the appeal(s) is (are) before us, but there is a question, surprisingly little discussed in the case law, whether the Comptroller's letter ruling is final agency action and therefore challengeable in a judicial review proceeding, or a mere advisory opinion, offering the bank the Comptroller's interpretation of his regulations but leaving the bank free to go ahead with its restructuring of the fund and to face the consequences, if any, of its defiance. A letter doesn't look much like final, formal agency action, and *New York Stock Exchange, Inc. v. Bloom*, 562 F.2d 736, 740-43 (D.C. Cir. 1977), held that a letter ruling by the Comptroller was not, while stressing that the form of the ruling should not matter. *Id.* at 740. See also *First National Bank v. Smith*, 508 F.2d 1371, 1373 n.8 (8th Cir. 1974). In the present case, however, the bank requested not advice, perhaps on a purely hypothetical course of action, but permission to go forward with a concrete proposal that it had already put to the fund participants for their approval – permission based either on the Comptroller's acceding to the bank's interpretation of the regulations or on his waiving them. The Comptroller turned the bank down. He did not – the point that was stressed in *Bloom*, and that distinguishes that case from this one – offer a merely tentative view. Nor did he address hypothetical possibilities, or request additional information before making a definitive ruling. He said flat out that the bank could not restructure the fund as it wanted to do.

If this was the equivalent of the denial of a license or other permit, it was appealable. *FTC v. Standard Oil Co.*, 449 U.S. 232, 239 n.8 (1980); *City of Anaheim v. FERC*, 692 F.2d 773, 781-82 (D.C. Cir. 1982). The objection to the equation is the bank's own argument that the instrument which established Institutional Real Estate Fund F and was approved by the Comptroller when the fund was set up already authorizes the proposed form of distribution, so that no further approval is required. If so, the bank can proceed with the distribution, albeit at some legal risk. It doesn't need permission.

But this hardly seems a realistic view of the bank's situation. The instrument allows distributions to withdrawing participants in the fund to be in cash or in kind, or partly in one and partly in the other, but it does not mention whole-property distributions. The instrument also does not use the word "ratably," but it does provide that it "shall be administered in conformity with rules, regulations and rulings, if any, issued by any duly authorized governmental agencies," and the Comptroller's form-of-distribution regulation is one of those regulations and it was in force in 1972 when the fund was established. In these cloudy circumstances, for the bank to make so controversial a distribution without an authoritative determination of its right to do so would be to expose it to enormous potential liabilities for breach of trust, which is why trustees traditionally are allowed to seek direction from the court before embarking on a controversial course of action; only in this case it is the Comptroller rather than a court that supervises the trustee's activities. Realistically, what the bank sought from the Comptroller and was refused was not advice,

but permission, and if the bank cannot challenge the denial of that permission it will have no practical opportunity to obtain a judicial interpretation of the regulation because it will have to fold its tent in the face of the Comptroller's disapproval.

This construal of the agency's action is especially persuasive with respect to the Comptroller's refusal to waive the regulations. That surely was not advice; it was, indisputably, final agency action; and we can think of no reason it could not bring with it into the reviewing court, by analogy to pendent appellate jurisdiction, *Cement Division v. City of Milwaukee*, 915 F.2d 1154 1158-59 (7th Cir. 1990); *Asset Allocation & Management Co. v. Western Employers Ins. Co.*, 892 F.2d 566, 569 (7th Cir. 1989); *Patterson v. Portch*, 853 F.2d 1399, 1403 (7th Cir. 1988), closely connected nonfinal rulings such as the Comptroller's interpretations of the regulations, if they were nonfinal. In any event we could not evaluate his refusal to waive the regulations without construing them.

Having satisfied ourselves, at last, with respect to jurisdiction in both the district court and this court, we can turn to the merits. The bank's principal argument is a technical but not a negligible one. The predecessor regulation to section 9.18(b)(6) provided that "when participations are withdrawn from a Common Trust Fund distributions may be made in cash or ratably in kind, or partly in cash and partly *ratably* in kind." 12 C.F.R. § 206.17(6), 2 Fed. Reg. 2976, 2978 (1937) ("Regulation F") (emphasis added). The word we have italicized was dropped in 1963, when, as an incident to Congress's transferring regulatory authority over national banks' trust activities from the Federal Reserve Board to the

Comptroller of the Currency, Regulation F was replaced by the present regulation, the only change being the deletion of the second "ratably." The Comptroller concedes that the deletion was deliberate – it wasn't just a slip-up in the process of repromulgation. The bank argues that so long as the fund adds some cash to its whole-property distributions, those distributions are authorized by the regulation because the requirement of ratable distribution applies only when a distribution is entirely in kind.

The argument disregards the deference that courts owe to agencies' interpretations of their own regulations – a point made by the Supreme Court with reference to investment regulations of the Comptroller of the Currency in *Investment Company Institute v. Camp, supra,* 401 U.S at 626-27. See also *Federal Reserve System v. Investment Company Institute,* 450 U.S. 46, 56-57 and n. 21 (1981); *Lyng v. Payne,* 476 U.S. 926, 939 (1986); *United States v. Baxter Healthcare Corp.,* 901 F.2d 1401, 1407 (7th Cir. 1990); *Homemakers North Shore, Inc. v. Bowen,* 832 F.2d 408, 411-12 (7th Cir. 1987). It also creates an irrational distinction in the regulation. Suppose that among the fund's properties are two worth $9.9 million and $10 million respectively, and a participant in the fund wants to make a $10 million withdrawal. Under the bank's interpretation, if it gives the withdrawing participant the $10 million property it violates the regulation, but if it gives the participant the $9.9 million property plus $100,000 in cash it does not. What sense could that make? The bank argues that if forbidden to make whole-property distributions, either it will have to liquidate – in what is widely believed to be a depressed market – a large part of its portfolio, in order

to raise cash to fund withdrawal requests; or it will have to give withdrawing participants fractional shares in all the properties in the portfolio, resulting in divided ownership and, in turn, high costs of transactions. Suppose fifteen participants withdraw all or part of their investment. Under "ratable" (proportional) distribution, each of the sixty properties would have sixteen owners – the fifteen withdrawing participants, each of whom would receive shares in each of the fund's properties, plus the fund itself. The more owners a piece of property has, the more costly it is to sell, improve, or otherwise transact with regard to it. This is the insight that underlies the right of a tenant in common to a partition of the property, the Rule in Shelley's Case, the presumption (about which we wrote recently in *Penn Central Corp. v. U.S. Railroad Vest Corp.*, No. 91-2608, slip op. at 2-3 (7th Cir. Feb. 4, 1992)) that the grant of a railroad right of way is an easement rather than a fee simple and therefore ceases, restoring undivided ownership, when the railroad discontinues service over the right of way, and many other doctrines of property law.

There is a second argument against forbidding the bank to make whole-property distributions. The value of a participant's interest in the fund upon withdrawal depends upon the appraised value of the properties owned by the fund. In a down market, such as we now have in commercial real estate in this country, market value may be below appraised value (unless there is frequent reappraisal). If so, cashing out a withdrawing participant on the basis of the appraised value of his share of the fund might confer a windfall – which might

in turn set off a race to withdraw. Whole-property distribution avoids this problem by giving the withdrawing participant property valued at the appraised value but presumably having a lower market value, rather than cash equal to the appraised value.

The second argument is easily met by pointing out that the bank is free to have its portfolio of properties reappraised in light of the current market situation. The first argument disregards the downside risk of whole-property distribution. Almost the entire idea behind a real estate investment fund is to allow investors to obtain a *diversified* investment in real estate, something a single investor unless truly huge would find very difficult to do because of the lumpiness of real estate compared for example to corporate securities. *Investment Company Institute v. Conover, supra,* 790 F.2d at 928; *Wisconsin Real Estate Investment Trust v. Weinstein,* 781 F.2d 589, 598 (7th Cir. 1986); cf. *Central National Bank v. U.S. Dept. of Treasury,* 912 F.2d 897, 902 (7th Cir. 1990); *GIW Industries, Inc. v. Trevor, Stewart, Burton & Jacobsen, Inc.,* 895 F.2d 729 (11th Cir. 1990). Diversification is lost as soon as the investor's interest is transformed from an undivided interest in a large and presumably diversified portfolio of real estate holdings into an interest in a single property. Ratable distribution preserves diversification, albeit with higher transaction costs, while cash distribution preserves diversification because the recipient of cash can forthwith invest it in some other diversified investment vehicle. In contrast, the recipient of a single building or other single chunk of real property must sell it before he can realize cash with which to make another diversified investment, and in the meantime he has an undiversified investment.

And every time a property is withdrawn from the portfolio and given to a withdrawing participant, the diversification of the portfolio declines, to the prejudice of the remaining participants.

The force of these objections should not be exaggerated. The investors in Institutional Real Estate Fund F are large and sophisticated and for all we know may be able to offset any loss of diversification as a result of their (or other participants') receiving a whole-property distribution by making adjustments elsewhere in their investment portfolios. (But of course as sophisticated investors they presumably relied on the terms of the original trust instrument, which was silent on whole-property distribution.) Moreover, they may not want the fund to be forced into either liquidating a large part of its portfolio or encumbering title to the properties in the portfolio with the fractional interests of the withdrawing participants. Withdrawing participants themselves might, all things considered, prefer to receive whole properties. The lopsided vote in favor of the restructuring proposal so suggests. And although, as we have said, the bank is incorrect in arguing that the trust instrument itself clearly authorizes the bank to make whole-property distributions, the instrument's very vagueness is some evidence that the participants did not wish to limit the bank's distribution choices as narrowly as the regulation as interpreted by the Comptroller does – though a contrary possibility is that the instrument was drafted in light of the Comptroller's consistent interpretation of the regulation.

The issues of finance and economics raised by the bank's forcefully presented arguments could be debated

at greater length, but the important point for us is that they are arguments against the regulation rather than against the Comptroller's interpretation. For the regulation explicitly and unequivocally requires ratable distributions in kind when the distribution is wholly in kind rather than partly in kind and partly in cash, yet the objections to forbidding whole-property distributions are independent of whether there is some cash or no cash. What is true is that a whole-property distribution *entirely* in kind is unlikely, because it would require that the fund just happen to have a property whose appraised value was exactly equal to the amount that the participant wanted to withdraw. But the bank makes nothing of this point, and perhaps this is right because the participant could always scale down (or up) his withdrawal request to the appraised value of some properties or properties owned by the fund.

So the reality is that the bank considers the regulation irrational but rather than challenging its validity asks us to create a loophole that would enable it to evade the regulation by adding a bit of cash to every distribution in kind. It says the cash component of the distribution would have to be more than *de minimis*. What could that mean? More than a dollar? More than a thousand dollars? More than a million dollars? As a matter of fact the restructuring proposal does not require the distributions to be partly in cash and partly in kind. If the value of the distributed property is less than the value of the withdrawing investor's interest, the bank must make up the difference in cash. But if the value of the distributed property exceeds the value of the withdrawing investor's interest, the investor must pay the fund the difference, in

which case the only distribution by the fund is in kind. The bank itself does not take its loophole seriously.

Which is not to say that it is unthinkable that the second "ratably" was dropped from the regulation in 1963 in order to create this loophole. Who knows what back-room deals lie behind the change in the regulation? There is no indication of a deal, however, and it is at least as likely that the word was dropped because the draftsman incautiously thought that it redundant. He may have thought that the first "ratably" would be understood as establishing that all distributions in kind must be ratable, and the following clause, dealing with distributions partly in cash and partly in kind, as merely waiving any requirement that a distribution be wholly one or wholly the other – but insofar as it has an in-kind component the distribution must be ratable. This reading is consistent with the semantics of the regulation, and though not compelled by them seems more plausible than the bank's reading, given the absence of any indications of deliberate loopholing.

We said that the bank has not contested the validity of the regulation, but we add that if its suit is construed, as perhaps it should be, as an oblique attack on that validity, it must fail too, because the criterion is not whether we agree with the regulation but whether it is reasonable. (Besides the cases cited earlier, see *Morales v. Yeutter*, No. 90-2787 (7th Cir. Dec. 18, 1991), and *Wisconsin Electric Power Co. v. Reilly*, 893 F.2d 901, 907 (7th Cir. 1990).) Our earlier discussion should make clear that it is.

The bank has other arguments, but only one has sufficient merit to require discussion. The Comptroller's

regulations provide that "funds . . . held by a national bank as fiduciary may be invested collectively, to the extent not prohibited by local law." 12 C.F.R. § 9.18(c)(5). The bank, interpreting "local law" to include ERISA (the Employee Retirement Income Security Act, 29 U.S.C. §§ 1100 *et seq.*), understands this regulation to mean that the Comptroller must allow the bank to manage the fund consistently with the "prudent man" standard of ERISA (all the fund participants are ERISA plans). And the bank regards that standard as requiring it, in the circumstances that it encountered at the end of 1989, to make whole-property distributions. This is not of course what the regulation says, and it's a pretty tortured way of arguing that the Comptroller should not interpret the form-of-distribution regulation to make an investment fiduciary act imprudently. We agree with *that* argument, but we do not think that the Comptroller's interpertation does compel, or for that matter authorize, imprudent conduct. Suppose the real estate market really is so "depressed" today that it would be imprudent to sell real estate in order to raise cash with which to pay off withdrawing investors in a real estate investment trust. Free-marketers may challenge the assumption, arguing that the market price, and not some real estate appraiser's appraisal (even if fully current), is the best, perhaps the only, measure of value. That is indeed a powerful argument with respect to a liquid market, such as the market in stocks traded on major stock exchanges – a market in which there are plenty of willing buyers and sellers, so that it is always possible to make a transaction that will reflect the value estimations of number of market participants. There are some illiquid markets, though, *Central*

National Bank v. U.S. Dept. of Treasury, supra, 912 F.2d at 902, and in them transaction prices will not always reflect market values, at least if "market" is defined to require some minimum number of potential transactors. If the author of this opinion decided to value his watch by soliciting bids from his two law clerks, he might get a less reliable valuation than from an appraiser. Likewise, if Institutional Real Estate Fund F decided to value a large office building by auctioning it off on an hour's notice, the price it received would not be a "market" price in any meaningful sense of the word. While normally "the real estate appraisal process depends on sales of comparable properties and other market data," "there have been few recent property sales in some markets, and bid and ask price may differ considerably." Wayne E. Etter, "Appraising in Difficult Markets," 6 *Real Estate Center J.* 14 (Jan. 1992). What *is* the value of a property when the owner is asking $3 million and a potential buyer is offering $2 million and there are no recent sales of comparable properties?

Illiquidity is what is behind the Comptroller's one-year regulation. A real estate investment fund is not required to sell properties the instant it receives a withdrawal request that exceeds its cash reserves; it can take up to a year to find a buyer. Given this leeway it is difficult to see how the bank in our case could be thought imprudent if it decided to sell over the course of a year a large part or for that matter the entirety of its real estate portfolio. To fault it for selling in a depressed market would be to commit the fallacy of supposing that a prudent investor is one who can time market turns – a fallacy

that investment law has at last rejected, prodded by modern finance theory. John H. Langbein & Bruce A. Wolk, *Pension and Employee Benefit Law* 539-40 (1990), and references cited there; *Hamilton v. Nielsen*, 678 F.2d 709, 712-13 (7th Cir. 1982). But if it should be imprudent to sell now, perhaps because, as the bank argues, though without substantiation, the savings and loans crisis has resulted in the placing on the market all at once of so much commercial real estate as to make it nearly certain that the bank could realize higher prices if it waited more than a year, all that this would mean is that instead of selling properties the bank should distribute fractional interests in them to withdrawing investors. That is not an ideal solution, because it makes such properties harder to sell. But whole-property distribution is not ideal either. Given a choice between comparable evils, neither could be pronounced imprudent by a court. The bank cites no case that condemns a fiduciary as imprudent for failing to make a whole-property distribution, and it would violate the supremacy clause for a state court to punish a fiduciary for complying with a valid regulation of the Comptroller of the Currency. There can be no violation of ERISA itself because that statute is explicit that it shall not be construed to invalidate or impair any federal regulation. 29 U.S.C. § 1144(d). And from all that we have said it should be plain that the Comptroller did not abuse his discretion in refusing to grant a waiver of the regulations.

We conclude that the ruling of the Comptroller denying the bank's request to be allowed to restructure the fund is valid in its entirety. The judgment of the district

court is modified accordingly, and as modified is affirmed.

MODIFIED AND AFFIRMED.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

The First National Bank of Chicago as Trustee of the Institutional Real Estate Fund F, Petitioner,	)	
v.	)	NO. 90 C 5963
The Honorable Robert L. Clarke, Comptroller of the Currency of the United States and the Office of the Comptroller of the Currency, an agency of the United States Respondents.	)	HONORABLE JAMES B. ZAGEL

MEMORANDUM OPINION AND ORDER

This action was brought by the First National Bank of Chicago in its capacity as trustee of a real estate collective investment fund, Fund F, following a ruling issued by the Comptroller of the Currency on July 17, 1990, rejecting the Fund F Restructuring Proposal. The Comptroller found that the Proposal conflicted with its regulations, specifically 12 C.F.R. sections 9.18(b)(4) and (6). First National argues that the Comptroller's ruling violates applicable law and the Comptroller's own regulations, and is arbitrary and capricious.

Facts

First National established Fund F by a Declaration of Trust in May of 1972. The participants in Fund F include employee benefit plans qualified under Section 401(a) of the Internal Revenue Code, governmental plans as defined in Section 414(d) of the Internal Revenue Code, and certain state deferred compensation plans properly qualified under the Internal Revenue Code. The forty-five institutional participants are knowledgeable investors whose investments range from less than fifty thousand dollars to more than one hundred million dollars. In June of 1990, the Fund F portfolio consisted of almost sixty real properties valued at approximately four hundred and ninety million dollars and approximately fifty-nine million dollars in cash or cash equivalents. Fund F is subject to both ERISA and the regulations of the Comptroller (12 C.F.R. sec. 9.18 *et seq.*). In addition, Fund F is governed by the laws of the State of Illinois in accordance with the terms of the Trust Agreement to the extent not preempted by ERISA.

In the late 1980s, the commercial real estate market plummetted and Fund F experienced a large increase in the number of withdrawal requests. At the same time, the market value of Fund F properties declined by approximately ten percent. The Bank/Trustee fell behind in payment of withdrawal requests. It decided, with the help of expert advice, that the quick sale of enough properties to satisfy the outstanding requests would further injure the Fund's value, to the detriment of the participants. Consequently, the Trustee, in December of 1989, announced it was suspending further withdrawals and distributions to participants pending consultation with the participants

and receipt of recommendations from its real estate advisors.

Currently, at least sixteen participants have outstanding withdrawal requests, at least eight of which have been pending for more than one year. Added together, these sixteen requests amount to twenty-five percent of the Fund F portfolio. On March 23, 1990, the Trustee submitted to all participants a proposal for the restructuring of Fund F. The Proposal called for dividing the participants into three categories according to their preference. Category I would consist of continuing participants, who would waive any right to cash withdrawals for a period of approximately five years. Category II participants would be paid their interest in the Fund in cash to be distributed over approximately three years. Category III would consist of participants who chose to withdraw from Fund F immediately; their withdrawal requests would be met with in-kind distributions of the whole ownership in certain real properties. Thirty-seven participants agreed; eight, who hold approximately twenty percent of the beneficial interest in the Fund, did not.

Representatives of the Trustee met with representatives of the OCC to discuss the Proposal. On March 30, 1990, the Trustee formally requested various rulings from the Comptroller to enable the Trustee to implement the Restructuring Proposal. On July 17, 1990, the Comptroller denied the Trustee's request. That denial precipitated this suit. Now, the Bank/Trustee moves for judgment on the pleadings and the Comptroller moves for summary judgment. The Court agrees that the matter may be resolved as a question of law on the basis of the record before it.

I.

The Administrative Procedure Act provides that a court reviewing an agency action "shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action." 5 U.S.C. sec. 706. In addition, "[t]he reviewing court shall (2) hold unlawful and set aside agency action, findings, and conclusions found to be – (A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; . . . (C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; . . . or (F) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court." 5 U.S.C. sec. 706(2)(A), (C), (F).

An administrative agency's interpretations of its own regulations are due great deference. *U.S. v. Baxter Healthcare Corp.*, 901 F.2d 1401, 1407 (7th Cir. 1990); *Wisconsin Elec. Power Co. v. Reilly*, 893 F.2d 901, 906-7 (7th Cir. 1990). The Supreme Court has said that "the scope of review under the 'arbitrary and capricious' standard is narrow and a court is not to substitute its judgment for that of the agency." *Motor Vehicle Manufacturers Assoc. v. State Farm Mutual*, 463 U.S. 29, 44, 103 S. Ct. 2856, 2866 (1983). The agency, however, must supply a satisfactory explanation for its decision after examining all the relevant factors in a case. *Id.* The court will not present "a reasoned basis for the agency's action that the agency itself has not given." *Id.*

II.

The first point of controversy involves in-kind distributions and whether they must be ratable. Section 9.18(b)(6) of the Comptroller's regulations provides:

> When participations are withdrawn from a collective investment fund, distributions may be made in cash or ratably in kind, or partly in cash and partly in kind: *Provided,* That all distributions as of any one valuation date shall be made on the same basis. 12 C.F.R. 9.18(b)(6).

The Comptroller claims that all in-kind distributions must be made on a ratable basis, reflecting the participants' proportionate interest in all assets. The Bank/Trustee, relying on the plain language of the regulation and the related clause in the Trust Instrument, asserts its right to act on the explicit provisions for the distribution of cash and whole properties.

The Comptroller argues that the two clauses in the regulation suggest flexibilty [sic] only in the type of distribution, permitting either cash distributions, ratable property distributions, or distributions combining cash and ratable portions of property. The "overriding requirement of ratability" remains the same. Another regulation states that all participants in a collective investment fund own a proportionate share of all the assets. 12 C.F.R. sec. 9.18(b)(3). This structure allows each participating trust "to enjoy greater diversification and wider investment opportunities than would otherwise exist." *Investment Co. Institute v. Conover,* 790 F.2d 925, 928 (D.C. Cir. 1986) *cert. denied,* 479 U.S. 939 (1986). The Comptroller argues that

the distribution of whole properties contravenes the purpose of participation in a collective investment fund; the participants would be saddled with narrow investments and greater managment [sic] costs and complications.

The Trustee/Bank counters the Comptroller's argument with the clear wording of both the regulation and the corresponding Trust clause. Section 5.4 of the Trust Instrument grants the Trustee the power, at the Trustee's discretion, to pay withdrawals "in cash or in kind, or partly in cash and partly in kind, provided that all distributions . . . as of one valuation date shall be made on the same basis." Every trust instrument which establishes a collective investment fund held by a national bank must be filed with, and essentially approved by, the Comptroller. 12 C.F.R. sec. 9.18(b)(1). The Bank, therefore, argues that the Comptroller-accepted Trust Instrument explicitly provides for non-ratable distributions of property.

The Comptroller's position that the Trust Instrument must be consistent with and must incorporate the rules and regulations of the OCC does not undermine the Trustee's argument. As the Trustee points out, the Trust Instrument is consistent; sec. 9.18(b)(6) plainly states "partly in cash and partly in kind." Furthermore, the Comptroller amended the regulation in 1963 and took out the second "ratably" from just where it attempts to read the word now. As first promulgated, the section read, "[D]istributions may be made in cash or ratably in kind, or partly in cash and partly ratably in kind. . . . " 12 C.F.R. sec. 9.17(b) (1962). The Comptroller advertently omitted the word ratably from the combination clause in 1963.

Both parties argue that common sense and the equities of the situation support their interpretation of the ratable issue, no matter how the regulation is written. The Comptroller uses sec. 9 of the Trust Instrument which prohibits amendments from operating "to deprive any particular participant of its then beneficial interest . . . in the Fund." This section, the Comptroller argues, motivated the Bank's attempt to garner unanimous approval by the participants for its Restructuring Proposal. Failing unanimity, the Trustee seeks, first from the Comptroller and now from the Court, waiver of provisions designed to protect the interests of participants. In its letter to the Bank and in its memoranda and argument to the Court, the Comptroller has based its unwillingness to permit distribution of whole properties to participants on the "principle of fairness." Nonratable distributions, the Comptroller argues, could work to benefit one participant at the expense of another. Citing appeals from a couple of participants in Fund F, the Comptroller equates nonratable distribution of property with a likely deprivation of beneficial interest.

The Trustee, with the advice of experts, paints a different picture. In its letter to the Comptroller, the Trustee noted that a ratable in-kind distribution "would result in [each] Participant receiving an individual interest in each and every property held by Fund F equal to the percentage interest held by that Participant in Fund F . . . . [A] withdrawing Participant who received in-kind distributions would receive partial, undivided interests in fifty-nine properties." Letter of March 30, 1990, p.6. That situation, according to the Trustee and its experts, especially "without the benefit of joint operating agreements

and provisions relating to control, sales, and dispute resolution imposed at acquisition, would *significantly diminish the value* of the properties to both Fund F and the transferee Participants." (emphasis added) *Id.* Ratable distribution of properties would threaten each participant's beneficial interest. Moreover, it would raise serious questions about the Trustee's fiduciary duty of prudence judged by the standards of ERISA (29 U.S.C. sec. 1104(1)(B)) and Illinois law (Ill. Rev. Stat. ch.17, para. 1675 (1989)).

The Court agrees with the Bank/Trustee's analysis and awards judgment on the pleadings in its favor on this issue. First, the Court notes that the plain wording of the regulation and the related clause in the Trust Instrument permits distributions "partly in cash and partly in kind." The Trustee is on solid footing when it relies on the explicit language of a regulation. The Comptroller fails to supply a satisfactory explanation for the deletion.[1] The Court will not defer to an interpretation unsupported by the text of the regulations and the Trust Instrument, short of an extraordinary and persuasive explanation by the Comptroller. That is not present here.

Second, the Trustee risks possible liability for breach of its duties and deprivation of a participant's beneficial interest due to its decision to distribute whole properties.

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[1] It was the Comptroller's position at the hearing that the regulations should be applied "rigidly" to sustain the reliance of other trustees and participants. We do apply the regulation rigidly. No English major could agree with the Comptroller's strained and self-serving interpretation that the word ratably in the second clause would be redundant.

That is the lot of trustees in times of troubled markets and difficult choices. The Comptroller cannot prevent the Trustee from taking a risky action that is apparently authorized by the regulations and the Trust Instrument. Rather, a determination of the prudence of the Trustee's action can be sought by any injured participant in a judicial forum. As the Trustee repeatedly has stated, it "is not seeking absolution from the Comptroller or th[e] Court."

Third, the Comptroller's common sense argument does not persuade the Court. The beneficial interests of the participants would seem to be at least as threatened by the ratable distribution of all properties in a shaky market as the outright distribution of whole properties. Difficulties of property management and direct ownership can be offset by the benefit of ownership of an intact property rather than bits and pieces of declining real estate all over the United States. The Trustee persuasively argues that "a fractional interest in a property without any mechanism controlling ownership perogatives [sic] is highly illiquid and close to worthless." Petitioner's Reply, p.11. The Comptroller's objection to non-ratable distributions rests partly on the existence of a few disgruntled participants. Concern for those outspoken participants might work to injure the beneficial interest of the majority of participants who agree with the Trustee on the most prudent course. The Comptroller's finding that in-kind distributions combined with cash distributions must be on a ratable basis is set aside for the reasons stated above.

III.

The second issue concerns the permissible time period for the Bank to honor withdrawal requests. Section 9.18(b)(4) provides in pertinent part:

> If a fund . . . is to be invested in real estate or other assets which are not readily marketable, the bank may require a prior notice period, not to exceed one year, for withdrawals.

The Comptroller, this time, argues the clear meaning of the regulation. The one year withdrawal period was specifically intended to accommodate the difficulties inherent in managing real estate funds. For funds invested in more readily marketable assets, the regulations require that withdrawals be honored on at least a quarterly basis, or sooner if the trust document so provides. 12 C.F.R. sec. 9.18(b)(4).

In addition, section 5.2 of the Trust Instrument requires a participant to give the Trustee one year notification of any withdrawal from Fund F, provided that the Trustee may, in its sole discretion, pay such withdrawal at an earlier date. The Trustee incorporated the Comptroller's regulation regarding the one year withdrawal period in this specific withdrawal clause and in the general regulations clause (sec. 11.1) in the Trust Instrument. It knew of the provision, adopted it, and strove to act on it when withdrawal requests were submitted. Now that the Trustee is in breach, it questions the meaning of the regulation and its own clause, suggesting that the one year notification period may be separated from the actual withdrawal period. This argument flies in the face of the text and the purpose of the regulation, and

even the Trustee spends little time on it. The plain meaning of the regulation weighs in favor of the Comptroller.

Two arguments by the Trustee present strong challenges to the Comptroller's ultimate finding that the one year withdrawal regulation applies and will not be waived. First, in a dicey market, local law prudence requirements may prevent the Bank from disposing of properties quickly and at a loss in order to satisfy timely requests for withdrawal. Second, many participants, who hold over eighty percent of the interest in Fund F, have voted to accept the Restructuring Proposal and some have thereby agreed to a delay in payment. The Trustee argues that those unconsenting participants should not be given veto power over the others, perhaps diminishing the beneficial interests of those who prefer to postpone redemption.

Local law, which includes ERISA and Illinois law in this case, demands prudence on the part of the Trustee. The Trustee realistically assesses the low price relative to value that it would be forced to accept for Fund F properties in a "fire sale" situation. Satisfying the outstanding withdrawal requests through property sales could seriously deplete the Fund, to the detriment of the remaining participants. The Trustee argues that local law takes precedence over the Comptroller's regulations and that following the Restructuring Proposal, with its delayed payment categories, is the most prudent course. In response to a liquidation question from another trustee, the Comptroller recommended that the asset sales occur when the trustee judged the sales to be in the best

interests of the participants.[2] Trust Interpretative Letter No. 50 (September 5, 1986). The Trustee contends that the real estate market today requires the same type of withdrawal schedule.

The Comptroller responds to this line of argument by challenging the Trustee's past conduct as imprudent.[3] Waiver of the one year requirement, the Comptroller argues, would not be necessary if the Trustee had maintained proper liquidity in the first place. Though the OCC recommends that trustees invest in a manner that effects a posture of sufficient liquidity, "it is likely required by the prudence standards of Illinois law and ERISA." Respondent's Memorandum, p. 29. The violation of a regulation, breach of a Trust Instrument, and breach of a fiduciary duty should not induce the Comptroller to reward the Trustee by waiving a regulation on which participants relied. In addition, the regulation concerning liquidation of funds carries no time limitation, distinguishing it from the regulation at issue.

The Trustee also argues for a waiver based on the majority support for the Restructuring Proposal. Thirty-seven participants consented to the Proposal; eight did

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[2] The Trustee should consider this if it decides that liquidation is the wisest course for Fund F in order to maintain the most value for the participants.

[3] The Court expresses no opinion on the Trustee's past conduct except to say that the participants are free to challenge the Trustee's management of the Fund in court and the Trustee may defend itself on the basis of prudence or the Trust Instrument provisions granting it some discretion. Either way, the past conduct of the Trustee should not be used to "punish" the Trustee with unfavorable rulings now.

not. The minority holds the majority hostage, the Trustee argues, by preventing the implementation of the solution engineered by the Trustee with expert assistance. This creates the classic moral hazard problem linked to requirements of unanimity. By refusing to go along, the unconsenting participants might get the most value for themselves, to the detriment of the other participants. The Comptroller, by handing the dissenting participants veto power, condones this "destructive angling for advantage." *See First National Bank of Louisville v. Continental Illinois,* 933 F.2d 466, 470 (7th Cir. 1991).

The Comptroller defends its position that unanimous consent is necessary under the beneficial interest clause. The determination of injury to beneficial interest should be made by the participants themselves, and at least some of them believe the Restructuring Proposal will deprive them of their interest in the Fund. Since those participants may have reasonably relied on the regulation requiring payment within one year, the Comptroller refuses to pull the rug out from underneath them now.

The Court defers to the Comptroller's decision not to waive the application of the one year withdrawal requirement in this case. The regulation and the Trust Instrument are clear and uncompromising on this point. The Comptroller merely requires adherence to a regulation known of and adopted by the Trustee. In addition, the participants of Fund F may have relied on this provision and deserve whatever protection and certainty it offers them in the management of their own plans. Finally, in light of its ability to distribute some cash and some property to satisfy pending withdrawal requests, the

Trustee should not encounter the fire sale and fund depletion problems to the extent it anticipated.

The Court appreciates the Trustee's desire to implement a plan it believes will preserve the most value to the most participants in a depressed real estate market. However, under the narrow "arbitrary and capricious" standard of review, the Court will not substitute its own judgment on this matter and will not set aside an administrative finding by the Comptroller based on a straightforward regulation and supported by a rational explanation. The Comptroller's motion for summary judgment is granted as to the one year withdrawal period.

Enter:

/s/ James B. Zagel
James B. Zagel
United States District Judge

Date: _____

APPENDIX C

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

July 17, 1990

Mr. Sherman I. Goldberg
General Counsel and Secretary
First Chicago Corporation
One First National Plaza
Mail Suite 0276
Chicago, Illinois, 60670-0276

Re: *First National Bank of Chicago Fund F*

Dear Mr. Goldberg:

This letter is in response to your correspondence of various dates on behalf of the First National Bank of Chicago ("Bank"), including the letter of June 20, 1990 from President Richard L. Thomas to Comptroller Clarke, regarding a proposal (the "Proposal") for the restructuring of a real estate collective investment fund (the "Fund") created and operated under a Declaration of Trust for which the Bank serves as Trustee. To the extent the Comptroller should determine that any feature of the Proposal is not consistent with any provisions of 12 C.F.R. § 9.18, the Bank has requested that the Comptroller waive the application of such provisions. In particular, the Bank seeks a ruling that the provisions of § 9.18(b)(4), which sets a one year limitation on the amount of prior notice a bank trustee may require for withdrawals from a real estate

collective investment fund, either do not apply under the circumstances presented or will be waived. Further, the Bank requests a ruling that § 9.18(b)(6), which requires cash or in kind distributions for collective investment funds to be made ratably, does not apply to the facts presented by the Bank or that the provisions will be waived in this matter. For the reasons set forth below, we find that the provisions of 12 C.F.R. §§ 9.18(b)(4) and (6) do apply to the facts as presented herein and that implementation of the Proposal would be in conflict with those provisions.

The facts as presented by the Bank indicate that in November 1989, the Fund had $530 million in assets and the Trustee had received $135 million in withdrawal requests, four of which had been pending in excess of one year. After consultation with its advisers, and in consideration of the extent of the pending redemption requests and the likelihood of additional redemptions, the Trustee concluded that generating cash through property sales under the prevailing market conditions would severely erode the value of the Fund and thereby damage all Participants, including those who wished to remain in the Fund. The Bank notes that none of the withdrawing Participants requested distributions in the form of property or pro rata interests in properties.

The Proposal offers three options to Participants regarding their investments in the Fund. Category I Participants would remain in the Fund with restricted cash withdrawal rights for approximately five years. Category II Participants would continue in the Fund while the interest of each Participant is liquidated for cash over a period of approximately three years. Category III Participants

would redeem their interests for an in kind distribution of Fund property upon implementation of the Proposal. Finally, Participants whose total investment in the Fund is $300,000 or less may elect to receive an immediate distribution in cash.

In Kind Distributions

Under the Proposal, Participants who seek immediate redemptions may receive in kind distributions in the form of 100% interest in a property or properties held by the Fund. To give effect to the Proposal, the Bank requests a ruling that § 9.18(b)(6) does not require a ratable distribution in this situation or waiver of all provisions implicated by in kind distributions.

With the exclusion of cash, the rule makes no distinction between types of assets to be distributed. Construed literally, the rule requires that any in kind property distribution be made ratably. In this case, an in kind distribution of property by the Trustee to a Participant, if made ratably, would result in the Participant receiving a proportionate undivided interest in each and every property held by the Fund. The Trustee has stated that such individual undivided interests would significantly diminish the value of the properties in the Fund.

The Trustee argues that pro rata, in kind distribution is not necessarily required under 12 C.F.R. § 9.18(b)(6), which was promulgated at a time when most collective investment funds held readily marketable securities which are easily apportioned on a pro rata basis. The effect of a pro rata, in kind distribution of real estate would be to decrease the value of the entire fund. The

Trustee would be unable to meet its obligation to act prudently in such a case. It follows then, according to the Trustee, that the right of the Trustee to distribute in kind is illusory. Moreover, the Trustee states there is nothing in 12 C.F.R. § 9.18 that would suggest an intention to limit the "tools available to a trustee administering a collective real estate fund."

The Trustee further maintains that an interpretation requiring ratable distribution of real estate assets is contrary to opinions issued by the Comptroller. *See* Trust Interpretation No. 20 (April 14, 1986); Trust Interpretation No. 181 (October 18, 1988), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 84,948; and Trust Interpretation 136 (January 15, 1988), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 84,903. The Trustee cites Trust Interpretive Letters No. 20 and No. 181 for the proposition that withdrawing from a trust should put the account in a better position. The Trustee argues that requiring in kind distributions of real estate would penalize the Participant rather than place the Participant in a better position, since the underlying trust assets would be unmarketable. These precedents, however, are inapplicable to this matter. Both letters concern request for specific provisions to be included in declarations of trust, not questions of compliance with existing trust provisions or requests for waivers from the requirements of provisions of 12 C.F.R. § 9.18. In fact, Trust Interpretive Letter No. 181, rather than supporting the Trustee's position, sets forth the Comptroller's long standing interpretation that the term "ratably" in 12 C.F.R. § 9.18(b)(6) requires that all distributions in kind must be made on a pro rata basis:

> A Participant in a fund has a pro rata interest in *each asset* of the fund. All withdrawals in kind must be on a pro rata basis. (emphasis added).

A letter dated April 1, 1986 by Dean E. Miller addresses the issue of a pro rata distribution of real estate. The letter concerned a bank real estate collective investment fund for employee benefit plans. Three participants made withdrawal requests totaling more than 15% of the current fair market value of the fund. The bank believed it would have liquid assets available to fund only 10% of the total amount requested and that it would take up to 12 months to dispose of sufficient real estate investments to fully fund the requests. The bank proposed the following: (1) that each participant requesting withdrawal receive cash equal to the lesser of $150,000 or the total amount requested; or (2) that all participants requesting withdrawal of an amount in excess of $150,000 be advised that withdrawal of the excess amount would be effected over the following 12 month period; or (3) that no additional requests for withdrawal be funded during the 12 month period unless all requests received as of March 31 were fully funded. The bank argued that honoring only some withdrawals or funding approximately 10% of all requests, would be detrimental to many participants. The OCC responded in pertinent part as follows:

> Units of participation in a collective investment fund are based upon a *proportionate interest in all the assets of the Fund*. A bank, as trustee, may not restrict a withdrawal to any specific amount, either of the participant's holding or of the market value of the fund. Neither should the trustee fully fund certain withdrawals and partially fund others. Such limitations are not consistent

> with the equitable operation of a collective investment fund. If there is insufficient cash and liquid assets to satisfy all withdrawals, *the available cash and/or assets should be distributed to withdrawing accounts based upon their proportionate interest in such cash and/or assets. Therefore, any distributions made as of March 31 should be on a pro rata basis in accordance with 12 C.F.R. 9.18.* (emphasis added)

Thus, the term "ratably" has been interpreted to mean a proportionate interest in all the cash or assets of a fund, including real estate.

The Trustee requests that should the OCC interpret the term "ratably" in 12 C.F.R. § 91.8(b)(6) to include real estate, a waiver of that provision be granted. The Trustee relies in great part on the assertion that real estate is not "readily marketable" and refers to 12 C.F.R. § 9.18(b)(4) which expressly so states, to argue that it would be inequitable to interpret § 9.18(b)(6) literally. A balancing of the equities, however, does not favor the waiver request. There can be no dispute that real estate is not marketable in the ready manner of certain securities. For this reason, the OCC has repeatedly recommended that such funds "maintain proper liquidity in the fund in order to operate in an equitable manner."[1] The potential for large and unexpected withdrawals "should be offset by a proper cash position."[2]

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[1] *See* Letter of Dean E. Miller dated August 13, 1970.

[2] *See* Letter of Dean E. Miller dated July 28, 1969.

The fact that in kind distributions of real estate are difficult to effect has not gone unrecognized by the OCC. This fact provides the underlying rationale of 12 C.F.R. § 9.18(b)(4), which allows a bank to require a prior notice "not to exceed" one year for withdrawals from funds invested in real estate. Prior to the inclusion of the notice period in § 9.18(b)(4), the OCC by interpretation had approved a prior notice period of one year for withdrawals from a real estate fund. In a letter signed by Dean E. Miller, dated June 27, 1979, the OCC stated that such "prior notice is permitted because of the time necessary to sell real estate." In 1981, this ruling was confirmed in Opinion 9.5960 which permitted a prior notice period of up to one year for redemptions, provided that no more than ten percent of any participant's assets were invested in the fund. On June 25, 1982, 12 C.F.R. § 9.18(b)(4) was amended to include as it does presently the one year notice period. Thus, while the difficulty of effecting in kind distributions of real estate speaks to the need for sufficient prior notice and the maintenance of a proper cash position, it does not serve as a basis for waiving the provisions of 12 C.F.R. § 9.18(b)(6) requiring that in kind distributions be made ratably.

Finally, the Trustee contends that § 9.18(b)(6) permits a nonratable distribution of whole properties in combination with some cash. 12 C.F.R. § 9.18(b)(6) allows fund distributions to be made "in cash or ratably in kind, or partly in cash and partly in kind." Although the term "ratably" is not included in the final subclause of this phrase, the OCC has interpreted § 9.18(b)(6) to require that all in kind distributions, including those consisting

partly of cash, be made ratably. The requirement is premised on the principle of fairness. Unless a distribution is made ratably, there always exists a possibility that one participant will benefit at the expense of another. Because 12 C.F.R. § 9.18(b)(6) applies both to funds invested collectively under § 9.18(a)(1) as well as section 9.18(a)(2), distributions of whole properties to individuals may be prudentially unadvisable and administratively unworkable. To read the clause "partly in cash and partly in kind" to allow nonratable distributions would allow a Trustee to evade the intent of the regulation through the inclusion of a nominal amount of cash. In reliance on this reading, a trustee could distribute whole parcels of property to a participant, effectively overriding the proportional interest of the remaining participants in the assets. Such a construction would render a nullity the parallel and undisputed requirement that solely in kind distributions be made ratably.

One Year Notice of Withdrawal

Implementation of the Proposal would further require a ruling that 12 C.F.R. 9.18(b)(4) does not apply under these facts or that a waiver of the provisions of 12 C.F.R. 9.18(b)(4) is appropriate. Since Fund assets are invested in real estate, the provisions of 12 C.F.R. 9.18(b)(4) do apply to the circumstances presented by the Trustee. We decline, however, to grant a waiver from the requirements of this provision.

The Declaration expressly incorporates in Section 5 the standard of § 9.18(b)(4) for funds invested in real estate that requests for withdrawal from the Fund must be

made upon prior notice, not to exceed one year. Therefore, any OCC action to waive or interpret § 9.18(b)(4) as the Bank requests has the direct effect of altering the agreement that the Bank made with its Participants.

The Trustee cites Trust Interpretive Letter No. 26 (April 14, 1989) as authority for the requested waiver. The Trustee contends that the Comptroller implicitly has acknowledged in this letter that in certain circumstances there may be insufficient cash and liquid assets to satisfy all withdrawals within the time period set by 12 C.F.R. § 9.18(b)(4). Under such circumstances, the Trustee argues, a pro rata distribution of cash and assets should be made to withdrawing accounts. Letter No. 26 does not, however, support the Trustee's position, for the bank requesting the opinion did not request a waiver of the one year redemption limit. That bank did, however, argue, much the same as the Trustee herein, that to fund withdrawal requests on a pro rata basis would result in funding approximately 10% of all requests to the detriment of many participants. To this contention, the OCC reiterated the position set forth in the Letter of April 1, 1986, referred to above, that where there is insufficient cash and liquid assets to satisfy all withdrawals, the available cash and assets must be distributed to withdrawing accounts in accordance with their proportional interests.

In addition, the Trustee relies on Trust Interpretive Letter No. 50 (September 5, 1986) as evidence of OCC policy, contrary to the language of § 9.18(b)(4), to require a trustee to make pro rata distributions without regard to the timing of the withdrawal request or the length of time such requests have been pending. Letter No. 50, however,

concerned the liquidation of a trust, not the treatment of redemption requests made pursuant to a trust agreement. There are no time limitations in 12 C.F.R. § 9.18 for fund liquidations. For this reason, the Letter acknowledged that liquidation of assets "should occur when sales are deemed by the trustee to be in the best interest of the participating trusts." The trustee of the liquidating trust was not bound by the terms of a trust agreement or regulatory provisions regarding the timing of redemptions. Given this fundamental factual difference, Letter No. 50 does not, therefore, provide support for the Trustee's request for waiver of the provisions of 12 C.F.R. § 9.18(b)(4).

There is an OCC interpretation directly relating to this issue that makes a waiver inappropriate. The OCC responded to a request from a bank for an exception to the provision allowing a one year period to fill requests for withdrawals. The bank was trustee of the bank's employee benefit real estate fund. With the exception of terminating trusts, the bank requested that the period allowed to honor redemption requests be extended from one to three or possibly five years. The OCC answered that "[s]ince all participants in the fund must be treated equally, we cannot accept a one year withdrawal period for only terminating trusts." *See* letter from Dean Miller dated November 20, 1973.

Conflict with Local Law

Finally, the Trustee asserts that its request for waiver is supported by 12 C.F.R. § 9.18(a). However, the cited provision does not support the Trustee's position.

The Trustee acknowledges that 12 C.F.R. § 9.18(a) provides for the collective investment of funds but construes the provisions of 12 C.F.R. § 9.18(b) to apply only "where not in contravention of local law." The Trustee contends that ERISA, as local law, governs fiduciary relationships and requires the Trustee to act prudently in all its actions. The Trustee then reasons that, since honoring the one year notification and redemption period would be imprudent, ERISA overrides the requirements of 12 C.F.R. § 9.18(b)(4).

The OCC has recognized ERISA as local law for purposes of § 9.18. As discussed below, however, 29 U.S.C. § 1144 provides that ERISA does not invalidate, impair or supersede any federal rule or regulation, including those that would apply to collective investment activities. Further, we find unpersuasive the argument that requirements for a trustee to act with prudence for the benefit of participants would be inconsistent with the notice or other provisions 12 C.F.R. Part 9. Accordingly, we cannot accept the argument that local law, i.e., ERISA, would prohibit in this instance the application of the requirements of Part 9.

The Ability of the Trustee to Alter the Terms of the Declaration of Trust.

Pursuant to a request by the OCC, on May 3, 1990, the Bank submitted a letter summarizing the legal authority of the trustee to implement the Proposal consistent with

the provisions of the Trust and the Trustee's fiduciary responsibilities under ERISA. The Bank indicated that the Trustee's authority derives from the broad powers reserved to the Trustee to administer the Fund, including the power to amend the Declaration, and the obligation of the Trustee to act in accordance with ERISA.

The Trustee first offers several provisions of Section 6 concerning the investment of Fund assets as support for its assertion of authority. Specifically, the Trustee notes that Section 6.3(f) allows the Trustee full power and authority to deal with the assets of the Fund. In addition, Section 6.6 states that the Trustee may exercise its rights and privileges with respect to those assets as though the Trustee was the owner thereof. The Trustee further calls our attention to Section 6.6(g) which provides in essence that the Trustee may exercise its powers and rights and perform any acts which in the judgment of the Trustee are desirable for the administration of the Fund regardless of whether these powers, rights and acts are specifically enumerated in the Declaration. The powers of the Trustee as set forth in these provisions are without dispute. However, it is equally without dispute that these provisions do not empower the Trustee to unilaterally and unconditionally override the terms of the Declaration.

The Trustee also relies on certain provisions of the Declaration which address distributions from the Fund. Section 5.2 expressly subjects withdrawal requests to the approval of the Trustee. Further, Section 5.4 allows the Trustee the option to distribute assets of the Fund in cash or in kind. Finally, the Trustee refers to Section 11.5 for the proposition that the Trustee has broad discretion in exercising its authority regarding distributions. Again,

the referenced powers of the Trustee are without dispute. However, again, these powers do not authorize the Trustee to act in contravention of the terms of the Declaration. In fact, Section 11.5, cited by the Trustee, only grants broad discretion in exercising powers provided for in the Declaration. Where the Declaration provides that any power may be exercised by the Trustee with discretion, then that discretion when exercised in good faith is absolute.

The Trustee next refers to Section 9 which provides:

> This Declaration may be amended at any time, and from time to time. . . . *No amendment shall in any manner operate to deprive any Participant of its then beneficial interest in the Group Trust or in any Fund.* (emphasis added)

This is the only section in the Declaration that addresses amendments to its terms. Section 9 appears to grant to the Trustee the power necessary to implement the Proposal, provided that the amendments do not "operate to deprive any Participant of its then beneficial interest." The determination of beneficial interest will be complicated and fact-intensive, depending in great part on the present valuation of the Fund and the potential for increase or decrease in the value of Fund property. In addition, it would seem that what is beneficial for each Participant is dependent on the portfolio and investment goals of each particular Participant. We note that certain Participants, that over a year ago made redemption requests in accordance with the terms of the Declaration, have beneficial interests that would be affected by alteration of the terms of the Declaration, especially the proposed waiver of the one year notice requirement. While

we decline to characterize the effect of the Trustee's proposed amendments on these Participants, we do observe that the parties to the Declaration are in the best position to assess these effects. This determination, then, is a matter to be resolved through negotiation between the Trustee and the Participants, a process that has already begun, with ultimate resort, if necessary, to the courts.

The second argument of the Trustee rests on the requirements of ERISA. The Trustee asserts that it is charged under Section 404(a)(1)(D) of ERISA with the responsibility to discharge its duties pursuant to the Trust "in accordance with the documents and instruments governing [trust] in so far as such documents and instruments are consistent with the provisions of this Title [I] or Title IV [of ERISA]." The Trustee interprets this provision to mean that the Trustee is obligated to follow the provisions of a trust document except where those provisions are inconsistent with ERISA. Essentially, the Trustee argues that to sell Fund property in order to comply with the one year notice provision would be a violation of its fiduciary duties. Thus, the Trustee concludes that it need not comply with that provision of the Declaration. Moreover, the Trustee contends that not only are the terms of the Proposal consistent with the Trustee's fiduciary obligations under ERISA but are in fact required.

We are not convinced that ERISA allows the Trustee to disregard the one year notice provision in the Declaration. In any case, the Department of Labor has primary jurisdiction to determine issues under ERISA. We do note, however, that even if ERISA did allow such a departure, 29 U.S.C. § 1144(d) specifically states that the provisions of ERISA shall not be "construed to alter, amend,

modify, invalidate, impair, or supersede any law of the United States . . . or any rule or regulation issued under any law." Thus, authority to override the provisions of a trust agreement would not authorize noncompliance with federal law or regulations, including 12 C.F.R. § 9.18.

Conclusion

We find no legal or equitable basis for departure from the OCC's longstanding interpretation and application of the provisions of 12 C.F.R. §§ 9.18(b)(4) and (6). For the reasons set forth above, we find those sections to be applicable to this matter and we decline to grant the Trustee's waiver requests.

If we can be of further assistance, please contact Donald Lamson or Susan Trippi of our Securities & Corporate Practices Division at (202) 447-1954.

Very Truly yours,

/s/ Stephen R. Steinbrink

Stephen R. Steinbrink
Deputy Comptroller
Multinational Banking

APPENDIX D

STATUTES AND REGULATIONS INVOLVED

A. National Bank Act

The National Bank Act of 1864, 12 U.S.C. § 1 *et seq.*, authorizes the Comptroller to supervise and regulate national banks. 12 U.S.C. § 92a(a) provides:

> The Comptroller of the Currency shall be authorized and empowered to grant by special permit to national banks applying therefor, when not in contravention of State or local law, the right to act as trustee . . . or in any other fiduciary capacity in which State banks, trust companies, or other corporations which come into competition with national banks are permitted to act under the laws of the State in which the national bank is located.

B. OCC Regulations

12 C.F.R. § 9.18(a) provides:

> Where not in contravention of local law, funds held by a national bank as fiduciary may be invested collectively:
>
> (1) In a common trust fund maintained by the bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as trustee, executor, administrator, guardian or custodian under a uniform gifts to minors act.
>
> (2) In a fund consisting solely of assets of retirement, pension, profit sharing, stock bonus or other trusts which are exempt

> from Federal income taxation under the Internal Revenue Code.

12 C.F.R. § 9.1(g) defines "local law" as "the law of the State or other jurisdiction governing the fiduciary relationship." Under 12 C.F.R. § 9.1(b), "fiduciary" includes a national bank "undertaking to act alone or jointly with others primarily for the benefit of another in all matters connected with its undertaking" and expressly includes a "trustee."

12 C.F.R. § 9.18(b)(4) provides in pertinent part:

> If a fund . . . is to be invested in real estate or other assets which are not readily marketable, the bank may require a prior notice period, not to exceed 1 year, for withdrawals.

12 C.F.R. § 9.18(b)(6) provides:

> When participations are withdrawn from a collective investment fund, distributions may be made in cash or ratably in kind, or partly in cash and partly in kind: *Provided*, that all distributions as of any one valuation date shall be made on the same basis.

12 C.F.R. § 9.18(c) provides for waiver of the Comptroller's regulations:

> In addition to the investments permitted under paragraph (a) of this section, funds or other property received or held by a national bank as fiduciary may be invested collectively, to the extent not prohibited by local law, as follows:
>
> * * *
>
> (5) In such other manner as shall be approved in writing by the Comptroller of the Currency.

C. ERISA

The Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1001 *et seq.*, provides rules for the conduct of trustees and other fiduciaries with respect to employee benefit plans.

ERISA § 404(a)(1)(B) requires a trustee to discharge its duties "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. . . . " (29 U.S.C. § 1104(a)(1)(B).)

ERISA § 404(a)(1)(D) states that a trustee shall discharge its duties "in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with [ERISA]." (29 U.S.C. § 1104(a)(1)(D).)

ERISA § 514(a) provides that the provisions of ERISA "supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan. . . . " (29 U.S.C. § 1144(a).)

ERISA § 514(d) provides that ERISA shall not "be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States . . . or any rule or regulation issued under any such law." (29 U.S.C. § 1144(d).)

D. Administrative Procedure Act

The Administrative Procedure Act ("APA"), 5 U.S.C. § 551 *et seq.*, provides that "[g]eneral notice of proposed

rule making shall be published in the Federal Register," including a "reference to the legal authority under which the rule is proposed" and notice of "either the terms or substance of the proposed rule or a description of the subjects and issues involved." 5 U.S.C. § 553(b). (Such notice is not generally required in the case of "interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice," or "when the agency for good cause finds . . . that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest" and states the reasons for that finding in the issued rules. *Id.*)

Section 553(c) requires that all "interested persons" have "an opportunity to participate in the rule making" by submitting comments. 5 U.S.C. § 553(c). Section 553(d) provides that the "required publication of . . . a substantive rule shall be made not less than 30 days before its effective date," except for "interpretative rules and statements of policy" or "as otherwise provided by the agency for good cause found and published with the rule." 5 U.S.C. § 553(d).

Supreme Court, U.S.
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No. 91-2052

In the Supreme Court of the United States

OCTOBER TERM, 1992

FIRST NATIONAL BANK OF CHICAGO, AS TRUSTEE,
PETITIONER

v.

COMPTROLLER OF THE CURRENCY

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTIONS PRESENTED

Regulations the Comptroller of the Currency promulgated pursuant to the National Bank Act require that distributions to participants withdrawing from collective investment funds be made "in cash or ratably in kind, or partly in cash and partly in kind" (12 C.F.R. 9.18(b)(6)) and, where the fund is invested "in real estate or other assets which are not readily marketable," that distributions be made within one year of a withdrawal request (12 C.F.R. 9.18(b)(4)). The issues are:

1. Whether the Comptroller's interpretation of his regulations to require that distributions be made ratably and within one year of a withdrawal request conflicts, under the facts of this case, with the duty of prudence imposed on trustees of employee benefit funds by the Employee Retirement Income Security Act (ERISA).

2. Whether the Comptroller arbitrarily construed Section 9.18(b)(6) to prohibit distributions of entire real properties.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	2
Argument	8
Conclusion	15

TABLE OF AUTHORITIES

Cases:

Guidry v. *Sheet Metal Workers National Pension Fund*, 493 U.S. 365 (1990)	10
Investment Co. Inst. v. *Camp*, 401 U.S. 617 (1971)	11
Investment Co. Inst. v. *Conover*, 790 F.2d 925 (D.C. Cir.), cert. denied, 479 U.S. 939 (1986)	14
Lyng v. *Payne*, 476 U.S. 926 (1986)	11
Patterson v. *Shumate*, 112 S. Ct. 2242 (1992)	10
Philbrook v. *Glodgett*, 421 U.S. 707 (1975)	12
Udall v. *Tallman*, 380 U.S. 1 (1965)	11
United States v. *Heirs of Boisdoré*, 49 U.S. (8 How.) 113 (1849)	12
United States v. *Larionoff*, 431 U.S. 864 (1977)	11

Statutes and regulations:

Bankruptcy Code, 11 U.S.C. 541(c)(2)	10
Employee Retirement Income Act of 1974, 29 U.S.C. 1001 *et seq.*:	
29 U.S.C. 1056(d)(1)	10
29 U.S.C. 1101-1114	5
29 U.S.C. 1104(a)(1)	9
29 U.S.C. 1144(d)	9, 10, 11
Labor-Management Reporting and Disclosure Act, 29 U.S.C. 501(b)	1
National Bank Act, 12 U.S.C. 92a	2
12 C.F.R.:	
Pt. 9	3

Regulations—Continued: Page

Section 9.17(b) (1962) 4
Section 9.18(b)(3) 12, 13
Section 9.18(b)(4) 3, 4, 7, 9
Section 9.18(b)(6) 3, 4, 6, 8, 9, 11, 12, 13, 14, 15
Section 9.18(c)(5) 7

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A20) is reported at 956 F.2d 1360. The opinion of the district court (Pet. App. A21-A34) is not reported.

JURISDICTION

The judgment of the court of appeals was entered on February 14, 1992. By order of Justice Stevens, dated May 12, 1992, the time for filing a petition for a writ of certiorari was extended to and including June 18, 1992, and the petition was filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner, the First National Bank of Chicago (bank), established Institutional Real Estate Fund F (Fund F or the fund) in 1972. Its 45 participants, all employee benefit plans, are sophisticated investors with investments in the fund ranging from $50,000 to $100 million. In 1990, the fund portfolio consisted of about 60 real properties valued at approximately $490 million and $59 million in cash or cash equivalents. Pet. App. A3.

During the late 1980s, when the commercial real estate market faltered, the value of Fund F's real estate holdings declined by approximately ten percent. At the same time, the bank received an increased number of withdrawal requests from participants. Because the fund did not have sufficient liquid assets to satisfy those requests, the bank fell behind in payments to withdrawing participants and, in December 1989, it suspended further withdrawals and distributions. Pet. App. A3.

In March 1990, the bank proposed a restructuring plan for Fund F which provided that any investor that wanted to make an immediate withdrawal would receive whole ownership of individual real properties. At that time, 15 participants had pending withdrawal requests, totaling approximately $135 million. Of the fund's 45 participants, 37, owning 80% of the fund's shares, agreed to the proposal. Pet. App. A4.

The bank also submitted the restructuring proposal to the Office of the Comptroller of the Currency (OCC).[1] The bank was concerned that the proposal

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[1] Under the National Bank Act, the Comptroller is authorized to grant national banks the power to act as a trustee. 12 U.S.C. 92a. The Comptroller's regulations governing the

might violate two OCC regulations. First, 12 C.F.R. 9.18(b)(6) provides that when a participant elects to withdraw from a collective investment fund, "distributions may be made in cash or ratably in kind, or partly in cash and partly in kind." In this case, the restructuring proposal called for the distribution of entire properties rather than distributions in the form of cash or a ratable share of the fund's holdings. Second, 12 C.F.R. 9.18(b)(4), which generally requires banks to honor requests for withdrawals from collective investment funds at least quarterly, provides that a fund invested in real estate or other assets not readily marketable "may require a prior notice period, not to exceed 1 year, for withdrawals." In this case, the bank proposed to honor all pending withdrawal requests, including eight that had been made more than one year before the restructuring proposal took effect. The bank sought either a ruling that its restructuring proposal did not violate the regulations or a waiver of the regulations. Pet. App. A36.

In July 1990, OCC denied the bank's request. Pet. App. A35-A49. OCC concluded that the proposal was inconsistent with the agency's longstanding interpretation of 12 C.F.R. 9.18(b)(6) requiring all distributions to participants withdrawing from a collective investment fund to be made on a ratable basis. Pet. App. A37-A42.[2] In addition, OCC declined to interpret 12 C.F.R. 9.18(b)(4) so that its one-year requirement

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powers and duties of such banks are set forth in 12 C.F.R. Pt. 9.

[2] In other words, the agency concluded that the distribution to each withdrawing participant should be made in cash or should reflect the participant's fractional interest in each of the fund's assets, but that the fund could not distribute entire real properties. Pet. App. A37.

did not apply in the circumstances facing Fund F. Pet. App. A42-A44. The agency likewise refused to waive the requirements of the regulations. *Id.* at A49.

2. The bank filed this action in the United States District Court for the Northern District of Illinois, seeking review of OCC's ruling under the Administrative Procedure Act. The bank moved for judgment on the pleadings and the Comptroller moved for summary judgment. Pet. App. A23. The district court rejected the Comptroller's interpretation of 12 C.F.R. 9.18(b)(6), relying primarily on the fact that a precursor of the current regulation (12 C.F.R. 9.17(b) (1962)) had explicitly stated that mixed in-kind and cash distributions must be made on a ratable basis. Concluding that the 1963 change in wording of the regulation had been "advertent[]," the court held that the current regulation (12 C.F.R. 9.18(b)(6)) provides that in-kind distributions need not be made on a ratable basis when combined with cash payments. Pet. App. A26, A28. The court also expressed its view that, in light of current market conditions, participants in Fund F would be better off with a right to receive whole properties than with a fractional interest in many illiquid assets. *Id.* at A29. Accordingly, the court set aside the Comptroller's ruling that in-kind distributions must be made on a ratable basis, even when combined with cash distributions. *Ibid.*

Regarding the one-year period for honoring withdrawal requests, the district court concluded that OCC's reading of 12 C.F.R. 9.18(b)(4) was correct. The court pointed out that the bank's conduct demonstrated that it was aware of the one-year requirement, had attempted to comply with it, and sought to avoid the regulation only when it had failed to honor withdrawal requests within one year. Pet.

App. A30-A31. The court also deferred to the Comptroller's decision not to waive application of this regulation, noting that its terms are "clear and uncompromising" and that the bank had incorporated the one-year requirement in the Declaration of Trust establishing Fund F. *Id.* at A33-A34. In addition, the court pointed out that, in light of its holding authorizing distribution of whole properties, the bank was unlikely to encounter the "fire sale" conditions that it contended would render compliance with the one-year requirement imprudent, in violation of its obligations under the Employee Retirement Income Security Act (ERISA). Pet. App. A33-A34.[3] The court therefore granted the Comptroller's motion for summary judgment "as to the one year withdrawal period." *Id.* at A34.

3. The court of appeals held "that the ruling of the Comptroller denying the bank's request to be allowed to restructure the fund is valid in its entirety." Pet. App. A19.

The court of appeals began by noting that the Comptroller's interpretation of his own regulation is entitled to deference. The court went on to point out that the bank's reading of the regulation would produce an irrational distinction between distributions that were made wholly in-kind and distributions that were made partly in cash and partly in kind. As the court explained, all agreed that a distribution consisting entirely of whole real properties would violate the regulation, but the bank contended that a

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[3] The investors in Fund F are all employee benefit plans, most of which are subject to Title I of ERISA. Accordingly, the fund must be managed prudently and in accordance with ERISA's other requirements. See 29 U.S.C. 1101-1114.

distribution that included some cash as well as real property would be in compliance. Pet. App. A11.

The court further noted that, because the bank's economic arguments in favor of whole property distributions applied whether or not such distributions were accompanied by some cash, the bank's suit was in fact an oblique challenge to the validity of the regulation as a whole and not simply a challenge to the Comptroller's interpretation of the clause relating to mixed in-kind and cash distributions. In effect, according to the court, the bank was asking for the creation of a "loophole" that would permit it to evade the regulation's requirement of ratable distribution "by adding a bit of cash to every distribution in kind." Pet. App. A15.

Acknowledging that the bank had made some economic arguments favoring whole property distributions, the court pointed out that the bank had failed to take into account the economic disadvantages of such distributions—specifically, loss of the diversification investors seek when they agree to participate in a collective investment fund: "[T]he recipient of a single building or other single chunk of real property must sell it before he can realize cash with which to make another diversified investment, and in the meantime he has an undiversified investment. And every time a property is withdrawn from the portfolio and given to a withdrawing participant, the diversification of the portfolio declines, to the prejudice of the remaining participants." Pet. App. A13-A14.

With respect to the language of 12 C.F.R. 9.18(b)(6), the court noted that it was impossible to say with certainty why, when the provision was amended in 1963, the Comptroller dropped the explicit requirement that in-kind distributions be made "ratably" even if accompanied by some cash. The court

concluded, however, that the Comptroller's reading of the amended terms to retain the requirement that all in-kind distributions be made ratably "is consistent with the semantics of the regulation, and though not compelled by them seems more plausible than the bank's reading." Pet. App. A16.

Finally, the court addressed the bank's argument that the Comptroller's interpretation required it to take action in violation of ERISA's " 'prudent man' standard," made binding under the Comptroller's own regulations (12 C.F.R. 9.18(c)(5)). Pet. App. A17. The court rejected the bank's contention that, under the prevailing economic circumstances, its obligation to act prudently compelled it to distribute whole properties rather than to sell assets in order to raise cash for distribution. *Ibid.* Acknowledging that an immediate sale of property in a depressed market could be imprudent (*id.* at A17-A18), the court pointed out that this problem of "[i]lliquidity" is exactly what "the one-year regulation" (12 C.F.R. 9.18(b)(4)), which gives the bank up to one year to find buyers for the properties it needs to sell, is designed to address. "Given this leeway," the court stated, "it is difficult to see how the bank in our case could be thought imprudent if it decided to sell over the course of a year a large part or for that matter the entirety of its real estate portfolio." Pet. App. A18.

The court added that the alternative of distributing fractional shares, although "not an ideal solution," was available if extraordinary market conditions made one year an insufficient period to obtain a reasonable price for the properties. Pet. App. A19.[4]

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[4] The court noted that the bank had not substantiated its argument that the savings and loan crisis had caused the market for commercial real estate to be flooded with properties

"Given a choice between comparable evils, neither could be pronounced imprudent by a court," the court concluded. *Ibid.* The court also stated, "we do not think that the Comptroller's interpretation [of 12 C.F.R. 9.18(b)(6)] does compel, or for that matter authorize, imprudent conduct." Pet. App. A17.

ARGUMENT

The court of appeals squarely held that the Comptroller's interpretation of its regulations to require ratable distributions from collective investment funds within one year of a withdrawal request does not require the bank to take any action that could be considered imprudent under ERISA's standard for fiduciary conduct. That court's decision therefore presents no conflict between ERISA and the National Bank Act, under which the Comptroller issued his collective investment fund regulations. Accordingly, contrary to petitioner's primary contention, there is no need for this Court to "harmonize" the two statutes. Petitioner also contends that the court of appeals erred by construing 12 C.F.R. 9.18(b)(6) to require ratable distributions. But the court's decision here, which is the first construction of 12 C.F.R. 9.18(b)(6) by an appellate court, is well reasoned and conflicts with no decision of this Court or any other circuit. Accordingly, this case does not present any issue warranting further review.

1. Petitioner correctly points out that the National Bank Act and the Comptroller's regulations issued pursuant to it incorporate the fiduciary standards set out in ERISA to govern the management of the funds

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for sale, thereby creating such extraordinary conditions. Pet. App. A19.

of employee benefit plans. Pet. 18-19. Petitioner argues that ERISA's requirement of prudent conduct by fiduciaries (29 U.S.C. 1104(a)(1)) compels it to distribute whole properties because neither of the alternative forms of distribution permitted under 12 C.F.R. 9.18(b)(6) as interpreted by the Comptroller would avoid large losses for the fund and for the withdrawing participants. Specifically, petitioner contends that: (1) under prevailing market conditions, the sale of properties to generate sufficient cash to satisfy withdrawal requests within the one-year limit of 12 C.F.R. 9.18(b)(4) would be a "fire sale" that would not realize the properties' true value; and (2) under any market conditions, distribution of fractional shares to withdrawing participants would result in divided ownership that would render the properties harder to sell and therefore less valuable. See Pet. App. A11-A12, A17-A19.

Leaping over the court of appeals' complete rejection of this argument and the court's holding that neither form of distribution permitted under the Comptroller's interpretation of 12 C.F.R. 9.18(b)(6) "could be pronounced imprudent by a court" (Pet. App. A19), petitioner focuses exclusively on a single sentence at the end of the court of appeals' lengthy discussion of the ERISA issue. In that one sentence, the court observed that "[t]here can be no violation of ERISA [by virtue of compliance with OCC regulations] because that statute is explicit that it shall not be construed to invalidate or impair any federal regulation." *Ibid.* (citing 29 U.S.C. 1144(d)).[5] Peti-

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[5] Section 1144(d) provides that ERISA shall not "be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States * * * or any rule or regulation issued under any such law."

tioner claims that the court's reliance on Section 1144(d) conflicts with this Court's decisions in *Guidry* v. *Sheet Metal Workers National Pension Fund*, 493 U.S. 365 (1990), and *Patterson* v. *Shumate*, 112 S. Ct. 2242 (1992), which, according to petitioner, held that ERISA's specific provisions control over the more general provisions of other statutes. Pet. 6, 10-11. At the very least, the bank argues, the court of appeals should have attempted to "harmonize" the requirements of ERISA and the Comptroller's regulations promulgated pursuant to the National Bank Act. Pet. 8, 18.[6]

Petitioner fails to acknowledge that the court of appeals had concluded, under the facts of this case, that ERISA and the National Bank Act are entirely harmonious. ERISA requires persons managing pension funds to act prudently and, the court held, it would not be imprudent for the bank to distribute assets in accordance with the options available to it under the OCC's regulations, construed as the OCC

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[6] In fact, in *Patterson* and *Guidry* this Court did not broadly hold, contrary to Section 1144(d), that ERISA preempts other federal laws, but instead harmonized the laws at issue. The ERISA provision at issue in both *Guidry* and *Patterson* was the statute's anti-alienation provision (29 U.S.C. 1056(d)(1)), which requires that "[e]ach pension plan shall provide that benefits provided under the plan may not be assigned or alienated." In *Patterson*, the Court held that ERISA was "applicable nonbankruptcy law" within the meaning of 11 U.S.C. 541(c)(2), a provision in the Bankruptcy Code, so that the anti-alienation provision should be given force in bankruptcy proceedings. 112 S. Ct. at 2248. In *Guidry*, the Court reconciled ERISA's anti-alienation provision with 29 U.S.C. 501(b), a provision in the Labor-Management Reporting and Disclosure Act authorizing unions to obtain "other appropriate relief," by holding that a union may obtain a judgment against a faithless officer but may not collect it from his pension account. 493 U.S. at 376.

construes them. Pet. App. A18-A19. Thus, no statutory conflict is presented by the facts of this case. Accordingly, the court of appeals' invocation of Section 1144(d) was entirely unnecessary to its judgment. In the absence of any conflict between the requirements of ERISA and of the Comptroller's collective investment fund regulations, this case does not provide an occasion on which this Court needs to address the scope of 29 U.S.C. 1144(d).

2. Nor is review warranted to consider petitioner's challenge to the OCC's ruling that 12 C.F.R. 9.18(b)(6) requires ratable distributions.

In construing 12 C.F.R. 9.18(b)(6), the court of appeals appropriately noted that it owed deference to the Comptroller's interpretation of his own regulation. Pet. App. A11. This Court has frequently recognized "the established proposition that an agency's construction of its own regulations is entitled to substantial deference." *Lyng* v. *Payne*, 476 U.S. 926, 939 (1986) (citing *United States* v. *Larionoff*, 431 U.S. 864 , 872 (1977), and *Udall* v. *Tallman*, 380 U.S. 1, 16-17 (1965)). As the court of appeals observed, this Court has emphasized this principle specifically in the context of the Comptroller's investment regulations. Pet. App. A11 (citing *Investment Co. Inst.* v. *Camp*, 401 U.S. 617, 626-627 (1971)).

The regulation at issue here, 12 C.F.R. 9.18(b)(6), states in pertinent part that "[w]hen participations are withdrawn from a collective investment fund, distributions may be made in cash or ratably in kind, or partly in cash and partly in kind." The Comptroller correctly rejected the bank's argument that the second clause ("partly in cash and partly in kind") permits non-ratable in-kind distributions so long as they are accompanied by cash payments. As the court of appeals recognized, the Comptroller's

interpretation is not only "consistent with the semantics of the regulation," but is also "more plausible than the bank's reading." Pet. App. A16. The first clause ("in cash or ratably in kind") authorizes two forms of distribution. This clause, which itself contains the conjunction "or," is set off by a single comma from the second clause. That second clause ("or partly in cash and partly in kind") simply permits the two methods of distribution already mentioned to be combined in a single distribution. If the regulation were intended instead, as the bank insists, to authorize three distinct forms of distribution—(1) cash distributions, (2) ratable in-kind distributions, and (3) a combination of cash and *non-ratable* in-kind distributions—the much more obvious construction would have been to list the three alternatives, each one set off from the others by commas. The Comptroller's conclusion that the second clause does not introduce a third and totally distinct form of distribution, but rather simply permits a combination of the two alternatives authorized in the first clause, is the better reading of the regulation.

Moreover, the Comptroller's interpretation is essential to give effect to other provisions of the collective investment fund regulations. As in any case involving statutory or regulatory construction, the Court "must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy." *Philbrook* v. *Glodgett*, 421 U.S. 707, 713 (1975) (quoting *United States* v. *Heirs of Boisdoré*, 49 U.S. (8 How.) 113, 122 (1849)). Pursuant to 12 C.F.R. 9.18(b)(3), "[a]ll participants in the collective investment fund shall be on the basis of a proportionate interest in all of the assets." An interpretation of the second clause of Section 9.18(b)(6) to permit distribution of entire real

properties to individual participants withdrawing from a collective investment fund would ignore the participant's rightful claim to a "proportionate interest in all of the assets" under Section 9.18(b)(3).

Furthermore, as the court of appeals recognized (Pet. App. A11-A12), the explicit requirement in the first clause of 12 C.F.R. 9.18(b)(6) that purely in-kind distributions be made on a ratable basis would, as a practical matter, be vitiated if the second clause permitted non-ratable in-kind distributions so long as they were accompanied by cash payments. As the Comptroller pointed out in his decision, "[t]o read the clause 'partly in cash and partly in kind' to allow nonratable distributions would allow a Trustee to evade the intent of the regulation through the inclusion of a nominal amount of cash." Pet. App. A42.

Read in the context of the collective investment fund regulations as a whole, the Comptroller's interpretation of 12 C.F.R. 9.18(b)(6) is not only "consistent with the semantics of the regulation" (Pet. App. A16), but is the more reasonable interpretation of the regulatory language. Contrary to the bank's argument (Pet. 21-22), this interpretation is not undercut by the regulation's history and, in particular, by the amendment of the regulation in 1963, which removed an explicit reference to ratable distribution in the second clause. Certainly, this change in the regulatory language was intentional. There is *no* evidence, however, that it was intended to implement the important substantive change urged by the bank. To the contrary, there is a reasonable linguistic rationale for the change. Not only is the phrase "partly ratably in kind" a very awkward formulation, it also creates an ambiguity: prior to the 1963 amendment, Section 9.18(b)(6) could have referred to in-kind distributions that were only *partly*

ratable. By removing the second "ratably," OCC prevented a reading whereby only a part of the in-kind distribution had to be made on a ratable basis. The change in wording thus eliminated one ambiguity even though, as this litigation demonstrates, it created another. This is precisely the kind of situation where deference to the agency's interpretation of its own regulation is particularly appropriate.

The Comptroller's interpretation of 12 C.F.R. 9.18(b)(6) to preclude non-ratable in-kind distributions not only is consistent with the language of the regulation, but also rests on important policy foundations. Collective investment funds are intended to permit participants "to enjoy greater diversification and wider investment opportunities than would otherwise exist." *Investment Co. Inst.* v. *Conover*, 790 F.2d 925, 928 (D.C. Cir.), cert. denied, 479 U.S. 939 (1986). Petitioner's interpretation of the regulation to permit non-ratable in-kind distributions would undermine this goal by disregarding the important principle of proportional ownership by all participants of all assets of the fund. As the court of appeals recognized (Pet. App. A13-A14), when assets are distributed on a non-ratable basis, the withdrawing participant loses the advantage of diversification of its investment. Likewise, the remaining participants lose their interest in the particular asset or assets that are distributed, and the fund as a whole becomes less diversified.

This problem is particularly acute where the assets of a collective investment fund consist of real property. Real estate values are volatile, and individual properties are unique. A property distributed to a participant today may, for any number of reasons, skyrocket in value tomorrow. The remaining participants will have lost their interest in this profit.

Conversely, the withdrawing participant may receive property today that next week depreciates significantly in value because of a natural disaster or other unforeseen event. Moreover, even in the absence of unexpected drastic changes in property values, distribution of entire properties to withdrawing participants shackles them with property management responsibilities that they never intended to assume.

In light of its consistency with the language of the regulation and its sound policy foundations, the Comptroller's interpretation of 12 C.F.R. 9.18(b)(6) to preclude distribution of whole properties to participants withdrawing from a collective investment fund is not arbitrary and capricious.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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In The

Supreme Court of the United States

October Term, 1992

THE FIRST NATIONAL BANK OF CHICAGO,
as Trustee of Institutional Real Estate Fund F,

Petitioner,

v.

THE COMPTROLLER OF THE CURRENCY
OF THE UNITED STATES,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

PETITIONER'S REPLY BRIEF

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PETITIONER'S REPLY BRIEF

The Brief in Opposition for the Respondent ("OCC") agrees with Petitioner that ERISA's requirement of prudent trust administration binds both the Trustee and the OCC. (ERISA § 404(a)(1), 29 U.S.C. § 1104(a)(1)) But the OCC further contends that the court of appeals performed such an analysis. (OCC's Brief pp. 10-11). Such an analysis was *not* performed by the court of appeals or by the OCC. Neither recognized any need to harmonize ERISA with the National Bank Act, because each believed that under ERISA § 514(d), 29 U.S.C. § 1144(d), the National Bank Act simply overrides ERISA. This override

position violates *Guidry v. Sheet Metal Workers National Pension Fund*, 493 U.S. 365 (1990), and other cases requiring harmonization of disparate federal statutory schemes, as this Court recently reiterated in *Patterson v. Shumate*, 112 S.Ct. 2242 (1992).

The Petition raises an important issue warranting review by this Court. A trustee needs to know whether adherence to OCC regulations "trumps" ERISA fiduciary law, however imprudent the trustee may deem such adherence to be, or whether ERISA's obligations of prudent investing must be balanced and harmonized with the National Bank Act, as required by this Court's precedents, including *Guidry* and *Patterson*.

If harmonization with ERISA is required, the OCC must explain, in a reasoned analysis, why it is justified in forcing compliance with OCC regulations that the Trustee has shown to be in conflict with ERISA's familiar prudence standards. The OCC did not even attempt this explanation; the court of appeals cannot and did not fill this gap.[1] Both the OCC and the court of appeals simply concluded that ERISA could never override an OCC regulation.

Permitting OCC regulations to "trump" ERISA would be especially anomalous since the purpose of OCC regulations is to permit national banks to exercise trust

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[1] The OCC's letter ruling of July 17, 1990 merely said that it found the Trustee's ERISA arguments "unpersuasive" (Pet. App. A45), and the court of appeals summarily concluded that "[t]here can be no violation of ERISA itself because that statute is explicit that it shall not be construed to invalidate or impair any federal regulation. 29 U.S.C. § 1144(d)." (Pet. App. A19).

powers. The hallmark of a trustee is prudent conduct, not mechanical obedience to fixed regulations. Congress rejected such mechanical obedience in passing ERISA in favor of "flexible" fiduciary standards. (Petition pp. 14-16).

This refusal to accept ERISA will cause trust beneficiaries undisputed injury, as demonstrated by the Trustee and its experts. The Trustee's unrebutted evidence is that millions of dollars of damage would be inflicted on trust beneficiaries if the OCC's regulations were adhered to, damage that would benefit no one and that could be avoided. The OCC's justification for inflicting this injury is its unsubstantiated conjecture that some unnamed participants might be benefited or harmed by the supposedly volatile nature of the properties the Trustee proposes to distribute. (OCC's Brief pp. 14-15). OCC conjecture cannot overcome unrebutted evidence, and this conjecture cannot justify inflicting enormous economic harm on the trust beneficiaries. Such proven harm should only be accepted if this is what Congress intended.

Actually, accepting the OCC'S position would frustrate the basic Congressional intent, repeatedly confirmed by this Court, to establish under ERISA a comprehensive and unified regime with flexible fiduciary rules for managing employee benefit plans, wherever their assets are invested. Endorsing the OCC's views strips all ERISA assets managed by national bank's of ERISA's protections. Such a marked diminution of ERISA's scope should only be countenanced after careful consideration of the two statutory schemes, as this Court required in *Guidry* and *Patterson*. The reader will search the court of appeal's

opinion in vain for this required analysis.[2] To fulfill this requirement, the Petition for a writ of certiorari should be granted and, if the Court deems it appropriate, the case should be remanded to the court of appeals for reconsideration in light of *Patterson*.

Respectfully submitted,

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[2] The OCC's brief also omits any response to Point II of the Petition, *i.e.*, that the OCC's interpretation of its own regulations was arbitrary and capricious and an improper amendment of the regulations under the Administrative Procedure Act. (Pet. pp. 21-24).